



Companion Report Decision  
Unsolicited Credit Assessments  
(EBA/DC/2017/195)

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18/07/2017

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## Report

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accompanying the Decision of the EBA confirming that the unsolicited credit assessments of certain ECAs do not differ in quality from their solicited credit assessments of 18/07/2017 (EBA/DC/2017/195)

## Summary of the analysis and final outcomes

1. This report describes the outcomes of the analyses carried out by the European Banking Authority (EBA) in the context of the mandate under Article 138 of Regulation (EU) No 575/2013<sup>1</sup> (Capital Requirements Regulation – CRR) for the External Credit Assessment Institutions (ECAIs) covered in the ‘Decision of the European Banking Authority confirming that the unsolicited credit assessments of certain ECAIs do not differ in quality from their solicited credit assessments’ (Decision) of 18/07/2017, which were not considered in the original Decision of 17 May 2016<sup>2</sup>. This document is to be considered as a report supplementing the Decision of 18/07/2017 through which the EBA provides its stakeholders with transparent information on its considerations regarding the ECAIs’ unsolicited credit assessments for the purposes of capital requirements calculations.
2. An ECAI is defined in Article 4(98) of the CRR as any Credit Rating Agency (CRA) that is registered or certified in accordance with Regulation (EC) No 1060/2009<sup>3</sup> (CRA Regulation), or a central bank issuing credit ratings which are exempt from the application of Regulation (EC) No 1060/2009.
3. Article 138 of the CRR permits the usage of unsolicited credit assessments of an ECAI for the purpose of capital requirements computation if the EBA has confirmed that they do not differ in quality from solicited credit assessments of that ECAI. In addition, the EBA shall refuse or revoke the confirmation if the ECAI has used an unsolicited credit assessment to put pressure on the rated entity to place an order for a credit assessment or other services. It should be emphasized that, in this context, the unsolicited ratings of an ECAI are compared with the solicited ratings of that same ECAI, and this exercise is not meant to compare credit ratings across different ECAIs.
4. The ECAIs considered under this report are the five newly established ECAIs that have been registered or certified after the EBA started producing the original Decision on unsolicited ratings published on 17 May 2016<sup>4</sup>, together with those ECAIs that started issuing unsolicited ratings following the adoption of that Decision<sup>5</sup>.

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<sup>1</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

<sup>2</sup> OJ C 266, 22.7.2016, p. 4-7.

<sup>3</sup> Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (OJ L 302, 17.11.2009, p. 1).

<sup>4</sup> Egan-Jones Ratings Co. (Egan-Jones), HR Ratings de Mexico S.A. de C.V. (HR Ratings), INC Rating Sp. Z o.o. (INC), mode Finance S.r.l. (modeFinance) and Rating-Agentur Expert RA GmbH (RAEX).

<sup>5</sup> CreditReform Rating AG (CreditReform).

## Definition of unsolicited credit rating and scope of the assessment

5. The CRR does not provide a definition for unsolicited credit assessment. However, as the CRA Regulation provides guidance on the applicable definition of unsolicited rating<sup>6</sup>, the provisions of the CRA Regulation are also relevant for the purposes of Article 138 of the CRR. Further, in December 2015 the European Securities and Markets Authority (ESMA) issued a Q&A<sup>7</sup> on the definition of unsolicited rating to clarify the interpretation of the CRA Regulation, which has been taken into account for the assessment of the six ECAIs under consideration.
6. This assessment exercise considers quantitative and qualitative factors as described below. Quantitative information was drawn from the statistics on the rating activity and the rating performance of ECAIs produced by ESMA (CEREP<sup>8</sup>), based on the information provided by the ECAIs as part of their reporting obligations<sup>9</sup>. Qualitative information was collected bilaterally from the ECAIs through a standardized questionnaire.
7. Due to the potential confidential nature of the information submitted to the EBA, ECAIs have been required to provide their consent for the publication of the information contained in this report. Indeed, the EBA, in line with its objectives and best practices, wished to provide (through this report) transparent information to its stakeholders regarding its work and the results obtained on unsolicited credit ratings for the purposes of own funds calculation by institutions.

## Main features of the assessment

8. Quantitative factors are sourced from the CEREP database. This ensured equal treatment across ECAIs and reliability of the information processed, as this data is submitted for regulatory purposes by ECAIs to ESMA under the CRA Regulation reporting requirements<sup>10</sup>. The CEREP data used by the EBA for the assessment covered up to reference date 31 December 2015<sup>11</sup>. Quantitative analyses to be potentially applied for each ECAI consisted of: i) the analysis of the distributions of solicited and unsolicited ratings (ex-ante distribution), ii) the analysis of the time evolution of solicited (unsolicited) ratings in relation to changes in rating category following a shift in solicitation type (ex-ante dynamics), and iii) the analysis of

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<sup>6</sup> Refer to Recital 21 of the CRA Regulation and to Article 3(1)(x) of that same regulation (as amended by Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013).

<sup>7</sup> [https://www.esma.europa.eu/file/13634/download?token=05de9eN\\_](https://www.esma.europa.eu/file/13634/download?token=05de9eN_)

<sup>8</sup> CEREP refers to the Central Repository of credit rating data reported to ESMA by credit rating agencies. <https://cerrep.esma.europa.eu/cerrep-web/>

<sup>9</sup> Article 11(2) of the CRA Regulation

<sup>10</sup> ECAIs submitted data in CEREP in accordance with Commission Delegated Regulation (EU) No 448/2012 of 21 March 2012, which has been repealed by Commission Delegated Regulation (EU) 2015/2 of 30 September 2014.

<sup>11</sup> It should be noted that there may be some delay between the submission of a credit rating and its incorporation into the CEREP database. This might create a misalignment between the types of credit ratings an ECAI states to assign, and the ones actually submitted. It is also the intention of the EBA to monitor, and update if appropriate, this assessment exercise under Article 138 CRR, which would allow to consider any developments related to the assignment of unsolicited ratings by ECAIs as well as new data reflected in CEREP.

the discriminatory power of the credit ratings systems depending on their solicitation type (ex-post analysis). More information on these methods can be found on Appendix 1.

9. Data availability severely limited the scope of the quantitative analysis. Out of the six ECAIs under consideration, three submitted CEREP data as of reference date 31 December 2015. Further, only HR Ratings reports both solicited and unsolicited credit ratings<sup>12</sup>. Data scarcity was a reflection of the nature of the newly established ECAIs, which due to the more recent entrance into the market presented limited credit rating data. ECAIs where quantitative evidence was not available are only assessed based on qualitative information, which was aimed at detecting potential misalignments between the policies, procedures and methodologies between solicited and unsolicited ratings.
10. The quantitative analysis was strongly affected by data availability, which did not allow for statistical analyses in relation to the solicited versus unsolicited ratings comparison. This is compounded with the fact that sufficient data are required not only on an aggregate level but also on homogeneous subsets of credit ratings.<sup>13</sup> This would require additional segmentation of the data and, therefore, even greater data availability.
11. Figure 1 of Appendix 1 shows for HR Ratings the CEREP credit ratings of type 'Sovereign and Public Finance', where both long-term solicited and unsolicited ratings were available.
12. With respect to the qualitative analysis, a standardized questionnaire was submitted to each ECAI. The factors under consideration were: i) analysis of differences on the assignment policy and review between solicited and unsolicited ratings, ii) analysis of differences in rating methodologies of solicited and unsolicited ratings, iii) data availability for unsolicited ratings, aimed at assessing any data availability restrictions for the assignment of unsolicited ratings and how these are managed, and iv) management of the pressure placed on the rated entity when offering unsolicited ratings, to assess whether the ECAI employs measures to prevent that the usage of unsolicited ratings puts pressure on the rated entity that would lead the latter to place an order for a credit assessment or other services. A summary of results can be found in Appendix 2.

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<sup>12</sup> Creditreform submitted exclusively solicited ratings and Egan-Jones registered unsolicited ratings only.

<sup>13</sup> Depending on the analysis to be performed, segmentation of the ratings should be performed to compare the relative characteristics of the credit ratings depending on their solicitation type in a way that avoids conclusions driven by external factors/intrinsic difference of the ratings.

## Assessment

### Quantitative

13. With respect to the quantitative analyses, only one ECAI (HR Ratings), presented evidence for both solicited and unsolicited ratings, albeit the latter was very scarce and did not allow for statistical analysis. Further descriptions are presented in Appendix 1:

- **Ex-ante distribution.** HR Ratings does not hold sufficient data for homogeneous subgroups of credit ratings for the purposes of this analysis.
- **Ex-ante dynamics.** Not applicable as there are no shifts in the solicitation status for the available credit rating data.
- **Ex-post analysis.** Not applicable as no defaults are registered for unsolicited ratings.

### Qualitative

14. With respect to the qualitative analyses, the outcomes for each ECAI under consideration have generally suggested that: i) there is no material difference with respect to the policies concerning the assignment and review of unsolicited ratings of an ECAI compared to solicited ratings of that ECAI; ii) there is no material difference with respect to the methodologies applied for the assignment of unsolicited ratings of an ECAI compared to solicited ratings of that ECAI; iii) although data availability restrictions might be present for unsolicited ratings of an ECAI compared to its solicited ratings, procedures are in place to guarantee that there is no underestimation of risks and/or difference in quality with respect to its solicited ratings; and iv) the ECAI employs measures to prevent that the usage of unsolicited ratings puts pressure on the rated entity that would lead the latter to place an order for a credit assessment or other services. The relevant information for each ECAI that is representative of these considerations is displayed in Figure 2 of Appendix 2.

### Final outcome

15. For the reasons presented in the previous paragraphs, the EBA has not identified any evidence of a difference in the quality of solicited and unsolicited credit ratings for the considered ECAIs, or of any pressure exerted by them on rated entities to place an order for a credit assessment or other services. Therefore, the EBA has considered it appropriate, at this stage, to confirm that the quality of those ECAIs' unsolicited credit assessments does not differ from their solicited credit assessments. Subject to the monitoring of the performances of the unsolicited credit ratings, the EBA might review the conclusions or the assessment methodology as described in the Decision, should it become appropriate.

## Appendix 1 – Quantitative Results

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**Figure 1:** Sovereign and Public Finance Long-term Solicited and Unsolicited Credit Ratings

HR Ratings

	Solicited	Unsolicited
2008H2	1	.
2009H1	4	.
2009H2	14	.
2010H1	20	.
2010H2	29	.
2011H1	38	.
2011H2	50	.
2012H1	63	.
2012H2	68	.
2013H1	64	1
2013H2	63	1
2014H1	63	1
2014H2	66	1
2015H1	84	1
2015H2	100	1

ECAIs that hold only solicited or only unsolicited Sovereign and Public Finance Long Term credit ratings are not displayed as the purpose of the assessment exercise is to compare solicited and unsolicited credit ratings.

Source: EBA calculations based on CEREP data.



## Quantitative analyses: description of the criteria for assessment

- **Ex-ante distribution of solicited and unsolicited ratings (ex-ante distribution).** The objective is to compare the rating distributions of solicited and unsolicited credit ratings. A material difference<sup>14</sup> between the distributions could indicate a deviation in experience, as well as rating process and methods, and should be explained by the ECAI.
- **Ex-ante dynamics of unsolicited ratings (ex-ante dynamics).** The objective is to analyse the time evolution of solicited (unsolicited) ratings that were previously assigned on an unsolicited (solicited) basis. In this context, it is useful to detect any trend reflecting a general upgrade (downgrade) of the rating after the change of the solicitation type. For example, this might provide some indications as to possible pressure exercised by the ECAI on the rated entity to place an order for a credit assessment or other services. Where frequent shifts in rating category are experienced after changes in solicitation type, the ECAI should provide motivations for those behaviours.
- **Ex-post analysis of solicited and unsolicited ratings (ex-post analysis).** The objective is to analyse the discriminatory power of the rating systems for solicited and unsolicited ratings, i.e. their capability to distinguish between well-performing entities from bad performing ones and consistently assign to the former better rating categories than to the latter. In this context, the area under the receiver operating characteristic curve (AUROC) statistic was used to get an indication of whether the discriminatory power, and thus the rating process and methodology, differed significantly between solicited and unsolicited ratings of the ECAI under consideration. It has to be emphasized that the usage of AUROCs in this context has to be handled with care,<sup>15</sup> and it should be stressed that these statistics have been employed as an initial indicator to assess whether further investigations were needed. The basic idea is that if unsolicited ratings showed a very poor AUROC and solicited ratings a very good AUROC, then this should be explained by the ECAI.

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<sup>14</sup> The term 'significant' might also refer in this context to some significance level threshold defined for selected hypothesis test used for the comparison. However a qualitative inspection has been preferred instead, taking into account that a certain variability should be expected among distributions and especially considering that it has not been possible to apply a granular segmentation of the ratings due to limited data availability.

<sup>15</sup> It should be taken into account that AUROCs depend crucially on the samples used, in that for example equally effective rating systems may present different accuracy indicators depending on the size and characteristic of the considered samples (e.g. risk profile). Therefore in this context AUROCs were used just in an indicative fashion and with consciousness regarding the limits for the interpretation of the outcomes, as a naïve usage of these statistics would lead to meaningless conclusions.

## Appendix 2 – Qualitative Results

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### Qualitative analyses: description of the criteria for the assessment

The selected qualitative criteria employed in the assessment consist of the following:

- **Policy regarding the assignment and review of unsolicited ratings.** The objective is to analyse the differences between the assignment and review policies of solicited and unsolicited ratings of the ECAI under consideration.
- **Rating methodology for unsolicited ratings.** The objective is to analyse whether any difference exists with respect to the rating methodology for solicited ratings, in which case it should be explained by the ECAI under consideration. It should also be specified how these may be applied differently (if at all), and whether more or less conservatism may be applied when assigning unsolicited credit ratings (e.g. how the rating methodology may be impacted by data restrictions).
- **Data availability for unsolicited ratings.** The objective is to analyse the most common restrictions of information faced by the ECAI during the assignment of unsolicited credit ratings in order to assess whether the possible lack of information could result in an underestimation of risk in the final rating assigned.
- **Management of the pressure on the rated entity when assigning unsolicited ratings.** The objective is to assess whether the ECAI has employed measures to prevent that the assignment of unsolicited ratings puts pressure on the rated entity that would lead the latter to place an order for a credit assessment or other services.

Figure 2 summarises the information provided by ECAIs in relation to the above mentioned criteria. It should also be noted that the information presented might not reflect all the information submitted by the ECAI to the EBA for the purposes of the assessment exercise under Article 138 of the CRR, as any confidential information provided by the ECAIs has been removed from the table below.

Figure 2: Qualitative information on unsolicited credit ratings of ECAIs

	<b>Policy regarding the assignment and review of unsolicited ratings</b>	<b>Rating methodology for unsolicited ratings</b>	<b>Data availability for unsolicited ratings</b>	<b>Management of the pressure on the rated entity when assigning unsolicited ratings</b>
<i>Creditreform Rating AG(Creditreform)</i>	According to information provided by Creditreform, there are no major differences in the general rating process when assigning or reviewing unsolicited ratings, so that unsolicited ratings essentially reflect the same analytical processes and are based on the same principles. In practice, minor operational deviations are that Creditreform is not commonly able to perform rating interviews for unsolicited ratings and sometimes faces fewer data availability.	Creditreform states that the tools and techniques that will be applied to conduct unsolicited ratings generally do not differ from those applied to solicited ratings, which is why the degree of conservatism is expected to be the same a priori. However, factually less extensive information may result in additional haircuts and will be reflected by the process of establishing the final rating.	Creditreform states that the creditworthiness or credit quality of a rating object will be typically assessed on the basis of publicly available information for unsolicited ratings. Common restrictions like the unavailability of rating interviews with the entity and/or fewer data can in most cases be handled via other supplementary information achieved through various means. Finally, if assumptions can only be established indirectly by reference to external databases, additional haircuts based on professional judgement may be applied and Creditreform will delay or abstain altogether from issuing unsolicited ratings in the absence of sufficient data.	Creditreform affirms that it asks and welcomes the entity's direct participation in the process of assigning an unsolicited rating, and that this participation goes without any demand for payment. Additionally, unsolicited ratings by Creditreform are not publicly available and are currently for the strictly internal use only (similar to private ratings). Creditreform also communicates to the entity that a future solicitation of the rating will usually have no influence on the rating result.
<i>Egan-Jones Ratings Co. (EJR)</i>	According to EJR, in general, the same policies and procedures regarding the assignment and review of solicited and unsolicited ratings are applied. However: - for unsolicited ratings, the analysis is not requested and paid by clients and all EJR's subscription clients have access	EJR states that the methodology for solicited ratings is generally the same as that for unsolicited ratings. The only differences are related to the data source (for unsolicited ratings only public information are used to produce the assessment) and to the indicators used to assess the credit quality (for solicited ratings	EJR states that for unsolicited ratings the issuer generally does not participate in the assessment and all information are found in companies' public filings or bought from some data provider especially regarding those particular asset classes (e.g. covered bonds) with a low level of public available data. The	EJR states that it generally uses public information to conduct unsolicited credit assessments and it rarely contacts the issuer for information; in addition the revenue comes from the rating subscribers not the issuers. The ECAI has in place a separation between the rating service and the other services.

	<p>to the ratings;</p> <ul style="list-style-type: none"> <li>- solicited ratings information is directly provided from clients, which is normally confidential;</li> <li>- only for solicited ratings there is a proper relationship in place with the rated entity in order to obtain and assess information and to obtain its approval for the publication of the final rating.</li> </ul>	<p>uses cash flow-based ratios, rather than using the income-based ratios for unsolicited ratings).</p>	<p>sufficiency of collected information is evaluated before issuing any rating and analysts are generally restrained from conducting the rating analysis if the data is limited.</p>	
<p><i>HR Ratings de México, S.A. de C.V. (HR Ratings)</i></p>	<p>According to the business model of HR Ratings, unsolicited ratings are assigned typically for the following reasons: 1. Sovereign ratings: these have been assigned mainly for internal reasons and have been published as part of their efforts to gain relevance in international markets. 2. To tap new markets and be known in regions or industries where HR Ratings previously does not have presence.</p> <p>According to HR ratings, there are no major differences in the general rating process when assigning or reviewing unsolicited ratings, except that the institution shall not be obliged to follow up the rating, that no payment is required and that unsolicited ratings could be withdrawn at any time.</p>	<p>HR Ratings indicates that unsolicited ratings will be performed with the same methodologies, policies and procedures than solicited ratings.</p>	<p>HR Ratings clarifies that, as of today, all unsolicited ratings released by HR Ratings have been produced with full collaboration of the rated entity and it had not encountered restrictions on the available information. In case HR Ratings does not have sufficient information available, following their policies, it can abstain from issuing an unsolicited credit rating. In addition, it could refrain from starting an unsolicited rating process if it does not have previous consent of the issuer following their current business model for issuing unsolicited ratings. HR Ratings states that, although this was the practice in the past, it does not guarantee that HR Ratings would not start an unsolicited rating process in the future following a different business model.</p>	<p>HR Ratings declares that, to avoid any potential pressure over unsolicited rated entities, HR Ratings released such ratings with previous full collaboration of the rated entity. Moreover, HR Ratings is in the process of enhancing its unsolicited rating procedure, to keep it as transparent as possible. For all issued ratings the rating process has included a notification that the HR Ratings will initiate an unsolicited rating process. HR Ratings indicates that the fact that none of the unsolicited rated entities has hired HR Ratings for an additional credit assessment or other services up to now is the best evidence to reflect the situation.</p>
<p><i>INC Rating Sp.</i></p>	<p>INC indicates that the same</p>	<p>The methodology remains the</p>	<p>Unsolicited ratings refer to local</p>	<p>According to INC there are no</p>

<i>Z o.o.(INC)</i>	policies and procedures are assigned to unsolicited and solicited ratings. The only differences are that (1) INC bears the cost of the credit assessment for unsolicited ratings (2) participation of the rated entity is sought, but potentially the rated entity may refuse (3) solicited ratings make use of up-to-date information while for unsolicited ratings access to information relevant to the ratings may only available at the time of the official data release.	same. The only difference is that in the case of unsolicited ratings the entity may wish not to participate. This is somewhat mitigated by the fact that INC only issues unsolicited ratings for local government units, which publicly disclose financial information.	governments, which are mandated to publicly disclose their financial statements. Moreover, the financial statements are also published by the Ministry of Finance so INC performs cross-checking among both sources. INC also assesses the financial statements of companies owned by the rated entity, mostly utility companies, which are directly available in the case of solicited ratings and available upon a fee for unsolicited ratings. In the case of unsolicited ratings a preliminary review of the weight of the companies owned by the rated entity is performed, so that only companies having a material influence are assessed.	differences in the rating process and participation is sought although no payment is required. There are limited concerns that the ECAI can put pressure to place an order as the underlying information for sovereigns is publicly disclosed and it exists competition in the market as other ECAIS produce credit assessments for some of the sovereigns rated by INC.
<i>ModeFinance S.R.L. (modeFinance)</i>	ModeFinance states that it applies the same policies and procedures for the assignment and review of unsolicited and solicited ratings. The only difference is that unsolicited ratings are assigned other than upon request of the rated entity and the assessment is produced avoiding any additional information provided by rated entity. At the time of the assessment all issued public ratings are unsolicited and they all started at internal initiative of the ECAI.	ModeFinance states that solicited and unsolicited ratings are obtained with the same methodology and show the same level of quality and conservatism. The only difference refers to the data source: solicited ratings may be based also on private information provided by the rated entity (i.e. private financial accounts, list of entities in peer group/industry, official credit registers etc.), while unsolicited ratings are based only on public information and/or additional information obtained at a cost.	ModeFinance states that, following its rating methodology analysts are required to gather all relevant public information on the rated entities. A credit rating may be issued only if a minimum set of standard information is available; in particular starting from a checklist on the availability and consistency of information, the rating process will be set out only if the amount of available information is greater than a fixed threshold.	ModeFinance considers the potential pressure of unsolicited ratings to be not significant under the current approach because it adopts an investor/subscriber pays business model and because most of its clients (related to the regulated rating activities and to the other provided services) are typically investors rather than issuers. In addition, according to internal policies, analysts have to carry out an independent assessment and rated entities cannot be clients for more than a given

		In order to guarantee that, despite to the lack of private information, there is no loss of quality in unsolicited ratings, specific tests are performed in order to assess the significance and the quality of the available information; whenever some minimum standards are not satisfied, the unsolicited rating is not issued.		percentage of annual turnover. At the time of the assessment, no contact from unsolicited rated entities was received.
<i>Rating-Agentur Expert RA GmbH (RAEX)</i>	RAEX states that unsolicited ratings cover only sovereign ratings for countries. According to the information provided, the policies and procedures regarding the assignment and review are mainly the same for both unsolicited and solicited ratings. The main differences are (i) there is no rating contract with the rated entity (ii) the rated entity does not provide any information (iii) there is no coordination process for the final rating/outlook. The difference in the review process is that the scheduled review for unsolicited ratings is performed on a semi-annual basis according to the calendar approved by the Advisory Board of the Agency.	RAEX indicates that the methodology applied for unsolicited ratings is the methodology of assigning sovereign government credit ratings and country credit environment ratings. It affirms that there is no difference in the methodologies caused by the solicitation status of ratings.	RAEX states that as sovereign ratings for countries are the only type of unsolicited ratings, it uses information from available reliable public sources. RAEX declares that, regardless of the solicitation status, the methodology does not consider actions which shall be taken in case there is limited data availability and the responsible expert decides if the rating assessment can or cannot be carried out with the available information. If there is not enough publicly available information, the RAEX's Rating Committee decides to withdraw or refrain from assigning a rating. In case there is a lack of quantitative information, the analyst may use the qualitative information and employ conservative approach.	RAEX declares that there is no pressure on rated entities for them to place an order when performing unsolicited credit assessments of sovereign ratings, since there is no payment for the rating assessment service and there is a possibility of public appeal, including for the rated entity itself.