

# **Response form for the Consultation Paper on Guidelines on risk factors under the Prospectus Regulation**



## Responding to this paper

ESMA invites responses to the questions set out throughout its Consultation Paper on Guidelines on risk factors under the Prospectus Regulation. Responses are most helpful if they:

- Q1** respond to the question stated;
- Q2** contain a clear rationale; and
- Q3** describe any alternatives ESMA should consider.

ESMA will consider all responses received by 05 October 2018.

## Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

- Q4** Insert your responses to the questions in the Consultation Paper in the present response form.
- Q5** Please do not remove tags of the type <ESMA\_QUESTION\_GRF\_1>. Your response to each question has to be framed by the two tags corresponding to the question.
- Q6** If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.
- Q7** When you have drafted your response, name your response form according to the following convention: ESMA\_GRF\_nameofrespondent\_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA\_GRF\_ABCD\_RESPONSEFORM.
- Q8** Upload the form containing your responses, **in Word format**, to ESMA’s website ([www.esma.europa.eu](http://www.esma.europa.eu) under the heading “Your input – Open consultations” → “Consultation on Guidelines on risk factors under the Prospectus Regulation”).

## Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. **Please clearly indicate by ticking the appropriate checkbox on the website submission page if you do not wish your contribution to be publicly disclosed.** A confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

**Data protection**

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading “Data protection”.

**Who should read the Consultation Paper**

This Consultation Paper may be of particular interest to investors, issuers, including issuers already admitted to trading on a regulated market or on a multilateral trading facility, offerors or persons asking for admission to trading on a regulated market as well as to any market participant who is affected by the new Prospectus Regulation.



## General information about respondent

Name of the company / organisation	Association for Financial Markets in Europe
Activity	Banking sector
Are you representing an association?	<input checked="" type="checkbox"/>
Country/Region	Europe

## Introduction

**Please make your introductory comments below, if any:**

<ESMA\_COMMENT\_GRF\_1>

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors, and other financial market participants. It advocates stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA), a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is registered on the EU Transparency Register (registration number 65110063986-76).

## General remarks on the proposed guidelines

AFME welcomes the opportunity to comment on ESMA's proposed guidelines on risk factors (Guidelines) addressed to NCAs. In general, the Guidelines provide helpful and proportionate direction around the new Prospectus Regulation (PR) requirements, both in relation to the content and the presentation of risk factors in prospectuses.

AFME has commented in this response on matters affecting equity securities and depositary receipts, as well as asset-backed securities (ABS).

AFME has also provided a mark-up of the Guidelines reflecting our comments, which begins on page 14 of this consultation response.

In advance of our response to the specific questions, we would make the following general points.

- *The role of the NCAs in applying the Guidelines in their review processes will be crucial*

We note that the Guidelines are addressed to national competent authorities (NCAs) for their consideration when scrutinising and approving a prospectus under the new PR, rather than to market participants and that the purpose of the Guidelines is stated to be “*general in nature and not limited to the risk factors of any particular type of entity or any particular type of prospectus*”. The Guidelines afford NCAs a considerable element of discretion in key areas, as we explain further below. There is the potential for differing approaches on the part of the NCAs in applying the Guidelines as part of their review processes. It will also be important that NCAs incorporate the flexibility envisaged by ESMA into their review and take into account the audience for the prospectus. ESMA may wish to address this issue as shown in our mark-up of the Guidelines (please see the first sentence of paragraph 5).

In this respect, the references in the Guidelines to different approaches being taken in relation to different types of prospectuses is helpful. It will be important that NCAs incorporate it into their application of the Guidelines and prospectus review processes to give effect to the Level 1 regime. Given the importance of observing this key principle, we would propose adding an express recognition of this point in the Guidelines.

- *Mitigating the risk of prospectus liability will drive issuer behaviour*

We suggest that any challenge to a risk-factor disclosure from an NCA should focus more on the question of how the information is presented in the prospectus (rather than whether a particular item of information or form of disclosure may be included). This is because the relevant persons responsible for the contents of a prospectus, namely the issuer and its directors, have potential legal liability to investors for the accuracy and completeness of the prospectus. In contrast, the NCAs who will use the proposed Guidelines in their review of the “specificity and materiality” of risk factors do not accept responsibility to investors for the prospectus. In some instances, NCAs are also protected by statutory immunity.

In the context of a large international offering of securities, there is potential for an investor to bring an action in a number of jurisdictions (including the U.S.) and for a range of countries’ laws to be invoked to determine liability. In this environment, those with liability for the accuracy and completeness of the prospectus are likely to need to take a conservative approach when deciding what risk factor disclosure to include in the prospectus, as it may be challenging to predict where, when or at whose instance such litigation may arise.

- *ESMA’s example risk factors should be viewed by NCAs just as examples and be set out in the ESMA Final Report rather than in the Guidelines themselves*

We note that the Guidelines provide a number of examples of what ESMA considers appropriate risk factors with explanations of how ESMA considers they adhere to the Guidelines. We think it is important that ESMA direct the NCAs to regard the examples in the Guidelines as illustrative examples only to be adapted for the context, rather than standard models to be copied out into prospectuses. ESMA may wish to address this issue as shown in our mark-up of the Guidelines (please see the final sentence of paragraph 5). It would be preferable if ESMA were to set out its illustrative examples in its Final Report only, rather than in the Guidelines, and describe them as examples. We explain this issue in more detail further below. Otherwise, we would be pleased to work with ESMA to suggest alternative examples or revised drafting.

ESMA may wish to consider the following points on the Guidelines.

<ESMA\_COMMENT\_GRF\_1>

### *Specificity*

- : **Do you agree with the suggested draft guidelines on specificity? If not, please provide your reasoning.**

<ESMA\_QUESTION\_GRF\_1>

- We note that each risk factor has to establish and describe a “direct” link so that the risk factor is relevant for the type of issuer and the securities (Guideline 1). This means that NCAs should challenge the inclusion of “boiler plate” or generic risk factors. However, in our view, the inclusion should only be challenged if such factors are not relevant to the issuer or the securities. In our view ESMA should recognise in the Guidelines that generic risk factors relating to a type of security or a type of issuer are likely to be relevant in all prospectuses for that type of security or issuer and permit their inclusion. ESMA may wish to address this issue as shown in our mark-up of the Guidelines (please see the final sentence of paragraph 15). In particular, risk factors relating to an issuer’s industry may be relevant to all issuers across that industry. In the case of ABS, the use of certain generic risk factors that go to the SPV nature of the issuer and the asset-backed nature of the debt securities in question will also be relevant for most deals. The Guidelines should still regard these as sufficiently specific and permit their inclusion.
- By way of example, we note the following non-exhaustive examples of boiler plate risk factors that are included in almost all equity prospectuses under the heading ‘Risks relating to the shares and the offering’, which should continue to be permitted to be included under the Guidelines. It would be helpful if ESMA were to include these, as illustrative examples, in its Final Report. This is because they highlight risks that should be brought to investors’ attention and/ or points that could constitute material omissions if not included (i.e. notwithstanding their ‘boiler plate’ nature).
  - “There is no existing market for the shares and an active trading market for the shares may not develop or be sustained”
  - “The price and trading volume of the Company’s shares could fluctuate significantly, and investors could lose all or part of their investments”
  - “Shareholders may experience dilution as a result of future offerings”
  - “Future sales by the selling shareholders or other shareholders could cause the share price to decline”
- The successful application of the Guidelines on specificity, and in particular Guideline 2, will therefore be dependent upon NCAs taking a pragmatic approach so that they do not require justification or confirmation of a general risk factor where its relevance is self-evident given the nature of the issuer, its business or of the securities.
- We do, however, agree that risk factors should not merely be copied from documents published by other issuers or previously by the same issuer if they are not relevant to the issuer at the date of the new prospectus or to the relevant securities.

- As noted above, it is important, in this context, that the example risk factors provided can be viewed by NCAs as mere examples and not templates for disclosure or as an illustration of the analyses that are appropriate in general in all contexts e.g. we note that the first example in Guideline 2 could apply to any form of natural disaster yet, as drafted, relates solely to flooding. Also, it is not as wide ranging as we would wish in its analysis of the possible consequences of the development.
- In addition to the above points, we consider that changes are desirable to the “sample” BRRD risk factor (example 2 at paragraph 18 of the Guidelines), as it is important that the materiality of bail-in risk disclosure for subordinated debt securities is linked to the fact that the issuer is a bank subject to the BRRD rather than to the fact that the issuer has *a significant amount of non-performing loans*; the latter is ESMA’s current formulation. The risk of being determined as *Failing or Likely to Fail* is relevant to any bank that is subject to BRRD, regardless of its financial situation (i.e. the amount of non-performing loans held on its balance sheet is merely one potential factor) since all the situations leading to recovery or resolution may not be anticipated by the issuer. ESMA may wish to address this issue in the Guidelines by the deletion of the reference to non-performing loans as shown in our mark-up of the Guidelines (please see the change to example 2). ESMA may also wish to amend its explanation in paragraph 23 of its consultation (at page 14) to insert the following wording shown in italics in substitution to its reference to non-performing loans: “Regarding example two, the materiality of the bail-in disclosure for subordinated debt securities is evident from the fact that *any Bank subject to BRRD* leaves potential unsecured noteholders in a precarious position, in the event the defaults increase above a quantifiable percentage”.

<ESMA\_QUESTION\_GRF\_1>

#### Materiality

- : **Do you agree with the suggested draft guideline 3? If not, please provide your reasoning.**

<ESMA\_QUESTION\_GRF\_2>

- We query why the IFRS definition of “materiality”, which was developed specifically for financial reporting, is relevant or appropriate when assessing the materiality of a risk factor. It does not recognise that materiality depends on the type of securities or the industry of the issuer, which are usually the key considerations. Article 16 of the PR, in conjunction with Article 6(1), already sets out the tests that an issuer will apply when determining the material risk factor disclosure.
- We suggest that Guideline 3 should be further amended to refer to the overarching prospectus disclosure standard in Article 6(1) of the PR which indicates that the necessary information which is material to an investor, in order to make an informed investment decision, may vary depending on the type of securities and the audience for the prospectus, is the relevant test for “materiality” in this context. ESMA may wish to address this issue as shown in our mark-up of the Guidelines (please see the suggested changes to paragraph 19). To put this into context, for a prospectus for equity, the investor is likely to want to know about factors that may affect the price of the shares or the issuer’s ability to pay a dividend and consider such factors to be material for disclosure. Investors in limited recourse ABS issued by SPVs will be focused on, among other things, the factors that may impact on the performance of the underlying assets as well as the counterparties and the deal structuring.

<ESMA\_QUESTION\_GRF\_2>

- : **Do you agree with the suggested draft guideline 4 on quantitative information? If not, please provide your reasoning.**

<ESMA\_QUESTION\_GRF\_3>

- We have concerns about ESMA’s draft requirements that the relevant risk factors must include either quantitative or qualitative disclosure and that mitigating language should not obscure the materiality of the risk.
- We would like to highlight that the Level 1 rules do not require the issuer to include quantitative information. We therefore believe that the Guidelines should only suggest the use of quantitative information as an example of the information that could be included to illustrate the impact of a particular risk factor on the issuer. We suggest that the emphasis on the need to disclose quantitative information is recalibrated, as shown in our mark-up of the Guidelines (please see our suggested changes to paragraph 20).
- The proposed guidelines encourage the disclosure of quantitative information “where available” in order to illustrate the potential negative impact of a risk even though Article 16(1) of the Prospectus Regulation only refers to “qualitative information” which *may* be disclosed to illustrate materiality and there is no reference to quantitative information. Despite the use of “where available”, an issuer does not appear to have the option not to disclose existing quantitative information and choose instead to prioritise the inclusion of qualitative disclosure when the issuer considers it more relevant for investors. There is a risk, in our view, that requiring the disclosure of quantitative information may become NCAs’ default approach, as it seems from the commentary that qualitative disclosure may only be used when quantitative information is unavailable.
- We further note that “quantitative information” is undefined by ESMA and could mean any information even if unsuitable for prospectus disclosure, for example because it is incomplete and potentially misleading to investors in the context of a prospectus. It may also not always be clear whether quantitative information is “available” or not, for inclusion in any particular prospectus risk factor. Therefore, we consider that there could be considerable uncertainty regarding whether appropriate quantitative information is “available” or not. For example, certain quantitative information may be technically “available” but outside the control of the relevant issuer. We also believe that issuers should have the option of not including quantitative information, even where quantitative information is available, if, for example, it is difficult for the issuer to provide such information publicly in a form which is not misleading to investors. Compliance with the guidance could be challenging for issuers who may need to spend a lot of time and costs undertaking diligence as to whether quantitative information is available for a particular risk factor and, if so, modelling that information to ensure it can be appropriately disclosed in a non-misleading manner.
- We also note that this Guideline could be interpreted to require disclosure of quantitative information even where this type of disclosure would not otherwise be required under IFRS (or another applicable accounting standard) from the perspective of the financial disclosure under the PR regime. An alternative approach would be for this Guideline to clarify (consistent with ESMA’s comments in paragraph 30 of the consultation paper) that: (i) quantitative information *may* be disclosed in the risk factors, if material, where the issuer is providing financial disclosure in the prospectus in accordance with IFRS (or another applicable accounting standard) and such financial disclosure is tailored to provide quantitative disclosure and information concerning financial risks; and (ii) ESMA does not consider it appropriate to reproduce the full content of financial disclosure into the risk factors section.



- If no quantitative information is available, the description of the potential negative impact of the risk factors may be described using a qualitative approach, and one option for the presentation of the materiality of risk factors may be by reference to the scale of low, medium or high (i.e. an optional weighted approach), but the persons responsible for the prospectus are not obliged to provide such a scaled ranking. This is preferable to a mandatory approach in case the scaling of risks (as low, medium or high) is shown to be incorrect, judged with the benefit of hindsight.

<ESMA\_QUESTION\_GRF\_3>

- **: Do you agree with the suggested draft guideline 5 on mitigating language? If not, please provide your reasoning.**

<ESMA\_QUESTION\_GRF\_4>

- We welcome that the guidelines in this area are broadly consistent with the U.S. securities law practice, as most international offerings of shares will include a distribution into the United States.
- We have concerns with the aspect of ESMA's approach relating to determining when mitigating language must not be included in a risk factor where it reduces the investor's understanding of the materiality of the risk and leaves the potential negative impact unclear. We note that ESMA considers that mitigating language is unclear unless it is used to illustrate the probability of a risk's occurrence and the expected magnitude of its negative impact. Where materiality is otherwise compromised by the use of mitigating language which reduces the materiality and obscures any remaining risk, we note that the Guidelines provide that the NCA can require such language to be amended or removed. In our view, where there are strong mitigating factors that render a risk factor immaterial, the current practice (which ESMA recognises in its commentary) under which the issuer is allowed to omit the risk factor should be allowed to continue, as an alternative. We believe that it is in the investor's best interests to know what measures are being taken by issuers to reduce the risk factors listed. Mentioning these measures should not be taken as mitigating language if such measures do not eliminate the materiality of such risks. We suggest that the reference to the NCA's approach is recalibrated as shown in our mark-up of the Guidelines (please see our suggested changes to the middle line of Guideline 5, and to the text of paragraph 24).
- We note that in Guideline 5, ESMA sets out an illustration of mitigating language which, according to ESMA, reduces the investor's perception of the materiality of a risk factor and obscures the remaining risk. We believe the specific example is unhelpful as it could easily be taken out of context and also some NCAs could take it literally so as not to allow any mitigating language even where the materiality is not compromised by the remaining wording of the risk factor and other elements of the prospectus disclosure. As such, we suggest that the example is removed from Guideline 5, as the remaining materiality of the risk factor should be analysed in accordance with the other relevant Guidelines.

<ESMA\_QUESTION\_GRF\_4>

#### *Corroboration*

- **: Do you agree with the suggested draft guideline 6 on corroboration of specificity and materiality? If not, please provide your reasoning.**

<ESMA\_QUESTION\_GRF\_5>

- As a general remark, we suggest that providing a guideline for corroboration does not relate to an area in which ESMA has a mandate to develop guidelines.
- It is helpful that Guideline 6 clarifies that the materiality and specificity of the risk factors can be demonstrated by either inclusion of specific corresponding information elsewhere in a prospectus or be identifiable by reference to the “overall picture” presented in the prospectus.
- However, we are concerned that Guideline 6 envisages that, in most cases, an NCA should not approve a prospectus where it is not apparent that materiality and specificity are corroborated by a reading of the prospectus. This means that ESMA’s default position seems to be that materiality and specificity of the risk factors will be corroborated by the corresponding item of information in the prospectus. This will, however, often not be the case, where, for example, materiality and specificity of a risk factor is identifiable by reference to the “overall picture” of the issuer and the securities, rather than by specific information elsewhere in the prospectus.
- We consider that the focus of this Guideline should be redrawn to recognise that in most cases the corroboration of the materiality and specificity of a risk factor will be self-evident and identifiable by reference to the rest of the prospectus. We also note in this respect that it is common market practice in prospectuses of equity securities and debt securities (including ABS) for the risk factors, where appropriate, to cross-refer to the relevant sections of the prospectus where further and/or related information is set out. Only in certain cases will more information to assess materiality and specificity of the risks be required and these should be narrowly characterised.
- If implemented as written, it seems likely that NCAs will add “corroboration” as a category to their prospectus review checklists, to facilitate the identification of compliance with the corroboration requirement. If this leads to risk factors being routinely amended by reference to information and sections in other parts of the prospectus, during prospectus reviews, this may increase the timelines and costs associated with prospectus reviews.
- If draft Guideline 6 is retained, we would suggest re-drafting the Guidance note as shown in our mark-up of the Guidelines (please see our suggested change to paragraph 25).

<ESMA\_QUESTION\_GRF\_5>

#### *Presentation of risk factors across categories*

- **: Do you agree with the suggested draft guidelines on Presentation of risk factors across categories? If not, please provide your reasoning.**

<ESMA\_QUESTION\_GRF\_6>

- We agree that it is helpful if each category of risk factors is identified by the use of appropriate headings (as ESMA proposes).
- Within each category, ESMA proposes that the most material risk factor must be presented first. It is helpful that there is no express requirement that all further risk factors within each category must be ranked in order of their materiality, as this helps avoid creating additional exposure to risk for issuers.

- The basis for the requirement (Guideline 7) that a risk factor should appear only once in the appropriate category is unclear. There is a risk that it could result in misleading disclosure for investors if a risk (or the subject-matter relating to the risk) is relevant to more than one category. Cross-referencing in each relevant category to the risk factor disclosed elsewhere would be a proportionate way of shortening the prospectus disclosure, if this is ESMA's concern. There is also the possibility that one factor produces impacts in different categories, resulting in risk factors that are closely linked (and potentially similarly drafted based on the same triggering factor) but focussing on different risks. ESMA may wish to address this as shown in our mark-up of the Guidelines (please see the suggested changes to paragraph 26). In addition, ESMA may wish to clarify that the examples of risk categories provided at paragraphs 28 and 29 of its Guidelines are non-exhaustive in nature (please see the suggested changes to paragraphs 28 and 29).
- It is helpful that Guideline 10 anticipates the use of sub-categories. However, framing this Guideline as a restriction and allowing the use of sub-categories only in cases where it can be justified on the basis of the particular type of prospectus is less helpful and is likely to lead to the divergence in approaches by the NCAs. In general, it should be noted that there is nothing in the Level 1 text that restricts the use of sub-categories, there is simply a general requirement relating to the use of a limited number of categories. In practice, it is likely to be helpful for investors if risk factors are ordered according to categories and then sub-categories. Indeed, it is already common market practice in the capital markets, including equity securities and ABS, for risk factors to be set out in a series of categories and sub-categories, the latter providing a helpful breakdown of different topics within a subject-matter/category of a risk factor, which makes risk factors disclosure more easily analysable. If sub-categories are restricted, different types of risks may be disclosed in one category or issuers may have to use a greater number of categories. Either approach may be confusing for investors. Therefore, we would encourage ESMA to consider re-framing Guideline 10 accordingly. ESMA may wish to address this as shown in our mark-up of the Guidelines (please see the suggested changes to Guideline 10 and paragraph 34).

<ESMA\_QUESTION\_GRF\_6>

- **: Do you agree with that the number of categories to be included in a risk factor section, should not usually exceed 10? If not, please provide your reasoning.**

<ESMA\_QUESTION\_GRF\_7>

- Limits on the number of risk factors or categories can be challenging to apply in practice, unless they take account of the factual context. We note that ESMA considers that including more than ten categories of factors in the case of a standard, single issuer, single security prospectus would be likely to be disproportionate and that fewer categories may be required in appropriate cases. It is helpful that this cap may be reduced or extended to take account of the relevant circumstances and also that ESMA would permit sub-categories and a degree of flexibility generally for larger, more complex prospectuses. We would invite ESMA to carry into the body of Guideline 9 the clarification in paragraph 42 of the consultation paper that the question of proportionality should be determined on a case-by-case basis and that the reference to 10 categories is a numerical illustration or starting point only. In particular we suggest that Guideline 9 should explicitly recognise the possibility of extending the limit where necessary owing to the complexity of the transaction or the risks connected with the issuer's business or the securities (or, in the case of ABS, any guarantor), If this approach is adopted, it is likely to be manageable for issuers and their advisers. ESMA may wish to address this issue, as shown in our mark-up of the Guidelines (please see the suggested changes to paragraph 32).

- Restricting the use of sub-categories is likely to mean that issuers have to use a greater number of categories when presenting risk factors. This would mean the limit in the Guidelines may become more challenging to adhere to. Additional flexibility with respect to sub-categories would be welcome.
- We note that Guideline 9 only refers to the risk to the issuer and omits any reference *to the risks relating to the securities*. ESMA may wish to remedy this, as shown in our mark-up of the Guidelines (please see the suggested changes to Guideline 9), given that a securities-related risk factor is an established category in its own right. We suggest that the words “or the securities” are added at the end of the draft guideline. We also suggest the addition of “relating to” after the words “transaction and risk”. The paragraph would then read as follows (with the changes to ESMA’s wording being shown in italics): “The competent authority should ensure that the number of categories included in the prospectus is not disproportionate to the size/complexity of the transaction and risk *relating to the issuer/guarantor or the securities.*”

<ESMA\_QUESTION\_GRF\_7>

#### *Focused/concise risk factors*

- **: Do you agree with the suggested draft guidelines on focused/concise risk factors? If not, please provide your reasoning.**

<ESMA\_QUESTION\_GRF\_8>

- As a general remark, we suggest that providing a guideline (Guideline 11) for risk factors to be presented in a concise form does not relate to an area in which ESMA has a mandate to develop guidelines.
- We appreciate that ESMA wishes to ensure that NCAs should address the issue of the size inflation of prospectuses where this is due to the inclusion of large quantities of information surrounding risk factors. However, it is not clear that a guideline is required to achieve this. There is an obligation to ensure that all prospectus disclosure (including risk factors) is written in a concise form in Article 6(2) of the Prospectus Regulation. ESMA may wish to reference this Level 1 requirement, as shown in our mark-up of the Guidelines (please see the suggested changes to Guideline 11).

<ESMA\_QUESTION\_GRF\_8>

#### *Summary*

- **: Do you agree with the suggested draft guideline on risk factors in the summary? If not, please provide your reasoning.**

<ESMA\_QUESTION\_GRF\_9>

- As a general remark, we suggest that providing a guideline for risk factors in the summary does not relate to an area in which ESMA has a mandate to develop guidelines.
- However, that said, we believe that ESMA’s suggestion for the order of risk factors in the summary reflects current practice. The disclosure of risk factors in the summary should be consistent with the presentation in each category in the body of the prospectus.

<ESMA\_QUESTION\_GRF\_9>

*General*

- **: Do you agree with the proposed draft guidelines? Have you any further suggestions with regard to draft guidelines addressing a particular section or the guidelines in general?**

<ESMA\_QUESTION\_GRF\_10>

Please see our general remarks at the start of this response.

<ESMA\_QUESTION\_GRF\_10>

- **: Do you believe that market participants will bear any additional cost as an indirect effect of the suggested draft guidelines? If yes, please indicate the nature of such costs and provide an estimation.**

<ESMA\_QUESTION\_GRF\_11>

- Yes, it is possible that there would be adaptive costs for issuers (in particular) and other market participants, if extensive re-drafting of risk factor disclosure is required as a result of the application of the Guidelines to meet the requirements of the relevant NCA. This will be especially challenging for issuers who distribute shares or issue debt securities (including ABS) in markets outside the EU, for example the United States, which have their own rules and investor expectations in relation to risk factor disclosure. The extent of these costs will partly depend on whether NCAs take a uniform and proportionate approach to the application of the Guidelines.
- In addition, where deals involve a distribution into the United States (as many do), issuers will wish to ensure that the information they disclose to investors is consistent across all markets, as departing from this approach is likely to give rise to significant liability concerns (and potential further costs) for issuers.
- Our mark-up of the draft Guidelines is set out below:

## ANNEX II: THE DRAFT GUIDELINES ON RISK FACTORS

### I. Scope

#### Who?

1. These draft guidelines are addressed to the competent authorities designated by each Member State in accordance with Article 31 of the Prospectus Regulation.

#### What?

2. These draft guidelines are to assist competent authorities reviewing the specificity, materiality and presentation of risks factors across categories depending on their nature. They have been drafted pursuant to Article 16 (4) of the Prospectus Regulation.

#### When?

3. These draft guidelines will apply from [date].

### II. References and Definitions

#### *Legislative References*

##### *Prospectus Regulation (PR)*

Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC.

##### *ESMA Regulation*

Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC.

Unless otherwise specified, terms used in the Prospectus Regulation have the same meaning in these draft guidelines.

In addition, the following definitions apply:

##### *Persons responsible for the prospectus*

The persons to whom responsibility for the information in a prospectus attaches, that is, as the case may be, the issuer or its administrative, management or supervisory bodies, the offeror, the person asking for the admission to trading on a regulated market or the guarantor and any further persons responsible for the information given in the prospectus and identified as such in the prospectus

<i>URD</i>	Universal registration document as defined in Article 9 of the Prospectus Regulation
<i>RD</i>	Registration Document

### III. Purpose

4. As stated in Recital 54 of the Prospectus Regulation, the primary purpose of including risk factors in a prospectus and/or a supplement is to ensure that investors make an informed assessment of such risks and thus take investment decisions in full knowledge of the facts. Risk factors should therefore be limited to those risks which are material and specific to the issuer and its securities and which are corroborated by the content of the prospectus.
5. The draft guidelines aim to encourage appropriate, focused and more streamlined disclosure of risk factors, in an easily analysable, concise and comprehensible form and take into account whether the prospectus is targeted at institutional only or institutional and retail investors. These draft guidelines are general in nature and not limited to the risk factors of any particular type of entity or any particular type of prospectus. The examples set out under Guideline 2 are illustrative only and are not to be regarded as standard formulations.
6. Although these draft guidelines are addressed to competent authorities pursuant to Article 16 (4) of the Prospectus Regulation, in order to expedite the process of approving prospectuses, RD, URD and any supplements thereto, persons responsible for the prospectus should consider these draft guidelines when preparing a prospectus for submission to the relevant competent authority.

### IV. Compliance and reporting obligations

7. These draft guidelines are addressed to competent authorities. Competent authorities shall make every effort to comply with these draft guidelines.
8. Competent authorities to which these draft guidelines apply should comply by incorporating them into their supervisory frameworks as appropriate and consider them when carrying out their scrutiny of a prospectus in accordance with Article 20 of the Prospectus Regulation.

#### Reporting requirements

9. Within two months of the date of publication of the draft guidelines on ESMA's website in all EU official languages, competent authorities to which these draft guidelines apply must notify ESMA whether they (i) comply, (ii) do not comply, but intend to comply, or (iii) do not comply and do not intend to comply with the draft guidelines.
10. In case of non-compliance, competent authorities must also notify ESMA within two months of the date of publication of the draft guidelines on ESMA's website in all EU official languages of their reasons for not complying with the draft guidelines.

11. A template for notifications is available on ESMA's website. Once the template has been filled in, it shall be transmitted to ESMA.

## V. Background

12. These draft guidelines are set out in bold and are followed by explanatory, elaborating and exemplifying paragraphs. Competent authorities should comply with the draft guidelines and should consult the subsequent explanatory, elaborating and exemplifying paragraphs during their review of risk factors.
13. When reviewing risk factors, competent authorities should note that the concepts of specificity, materiality and corroboration are linked, as illustrated in Article 16(1) of the Prospectus Regulation. Risk factors should be both specific and material to be included in the risk factors section as set out in Article 16(1) of the Prospectus Regulation. It should be clear that both criteria have been fulfilled where a risk factor is included in a prospectus.

## VI. Draft guidelines on risk factors

### VI.1. Draft guidelines on Specificity

**Guideline 1: The competent authority should review whether the disclosure of the risk factor establishes a clear and direct link between the risk factor and the issuer, guarantor or securities. The competent authority should challenge the persons responsible for the prospectus if it appears that risk factor disclosure has not been drafted specifically for the issuer/guarantor or the securities.**

14. Specificity related to the issuer/guarantor may depend on the type of entity (e.g. start-up companies, regulated entities, specialist issuers, etc.) and specificity related to the type of security may depend on the characteristics of the security.
15. Each risk factor should identify and disclose a risk that is relevant for the issuer/guarantor or the securities concerned rather than simply disclosing 'boiler-plate' risks or using 'boiler-plate' disclosures. Nevertheless, generic risk factors are permissible if they are specific to the security or type of issuer (e.g. 'an active trading market for the securities may not develop').
16. Risk factors should not merely be copied from other documents published by other issuers or previously by the same issuer if they are not relevant to the issuer/guarantor and/or the securities.

**Guideline 2: The competent authority should challenge the inclusion of risk factors that are generic and only serve as disclaimers or where there is no clear and direct link between the issuer/guarantor or the securities and the risk factor. Where necessary, the competent authority should request that the persons responsible for the prospectus amend such risk factor or request a clearer explanation. The competent authority should not approve a prospectus where specificity is not apparent from the disclosure of the risk factor.**



17. The following could be considered examples of disclosures that illustrate the specificity of risk factors to the issuer, or extracts from risk factor disclosures that show a clear and direct link between the risk factor and the issuer.

- 1) If an issuer includes a risk factor relating to natural disasters this should be linked back to the issuer's spread of activities in order to establish its specificity, for example:

The main production site of the issuer (factory ABC), which produced 30% of the issuer's turnover last year, is situated close to a river which floods almost every spring. The overflow of water may impair the transport of inventory to distribution centres and consequently may interrupt the delivery of goods to end-customers. Contracts with several of the issuer's key customers give those customers the right to pay a reduced price for the issuer's goods if goods are not delivered on time. In addition, the majority of the issuer's contracts with its customers are for periods shorter than one year. Late delivery may adversely affect the issuer's reputation with its customers and result in their turning to the issuer's competitors for their future requirements.

- 2) If an issuer includes a risk factor relating to environmental, social or governance matters its specificity could be described as follows:

The issuer is required to comply with a rigorous set of sustainability criteria, in order to maintain its ISO certification. The issuer is subject to a bi-annual evaluation by (authority XYZ) which may decide to revoke the issuer's ISO certification on a failure to comply basis. The issuer is dependent on maintaining its ISO certification in order to maintain its contract as a supplier for its two largest customers. Goods supplied to these two customers generated 40% of the issuer's operating profits last year.

18. Where relevant, the following could be considered examples of disclosures, or extracts of risk factor disclosures, which illustrate the specificity and materiality of risk factors to the security subject to an assessment by the persons responsible for the prospectus pursuant to obligations under Article 16 of the PR:

- 1) The degree of liquidity of such securities:

After the completion of the offering and assuming that all [XX] shares will be sold in the offering, only [YY] % of the company's share capital will be freely tradable. This may have a negative impact on the liquidity of the shares and result in low trading volumes. The degree of liquidity of the securities may negatively impact the price at which an investor can dispose of the securities where the investor is seeking to achieve a sale within a short timeframe.

- 2) The subordination of the securities (e.g. for certain regulated entities, the impact of recovery and resolution tools including bail-ins):

The subordinated notes constitute unsecured debt claims over Bank ABC.

Bank ABC is subject to the Bank Recovery and Resolution Directive, which is intended to enable a range of actions to be taken in relation to credit institutions and investment firms considered to be at risk of failing. The taking of any action under the BRRD in relation to the issuer could materially affect the value of, or any repayments linked to, any note issued, and/or risk being converted into equity.

~~Bank ABC holds a significant amount of non-performing loans.~~ If Bank ABC is determined Failing or Likely To Fail within the meaning of BRRD, and the relevant authority applies any, or a combination, of the BRRD resolution tools (e.g. sale of business, asset separation, bail-in or creation of a bridge bank), any shortfall from the sale of Bank ABC's assets may lead to a partial reduction in the amounts outstanding to the subordinated noteholders or, in a worst case scenario, a reduction to zero. The subordinated status of the noteholders constitutes an additional risk considering the sequence of write down and conversion under the BRRD (e.g. subordinated notes are written down and/or converted, if necessary, after the share, but before the senior debt securities).

The relevant authority may seek to amend the terms of the maturity date of the notes, which could negatively affect the value of the notes for the purpose of re-selling.

Each of the aforementioned measures may occur in isolation or, they may occur as a combination. For instance, the relevant authority may require a partial conversion of the subordinated notes into ordinary shares of the Bank ABC, in addition to any write-down and sale of Bank ABC's assets.

Public financial support to resolve Bank ABC where there is a risk of failure will only be used as a last resort, having assessed and exploited the other resolution tools to the maximum extent practicable whilst maintaining financial stability.

- 3) Exchange rate risk in a base prospectus where multiple currency bonds may be issued via final terms, where the currency of the home and host Member States is the euro:

Bonds issued via final terms pursuant to this Debt Programme may be issued in a currency which is not the euro, such as the Eurodollar or Euroyen bonds. According to the terms and conditions of the base prospectus, all payments related to certain bonds, including interest, may therefore be in dollars, yen or any other currency specified in this base prospectus.

The euro value of any payments may be subject to significant fluctuations in exchange rates. The degree to which such exchange rates may vary is uncertain and presents a highly significant risk to the value and return of any bond issued pursuant to this Programme.

Significant movements in currency exchange rate may not correlate with movements in interest rates and the timing of changes in the exchange rates may negatively affect the yield, the return and market value of the bonds. This may result in a significant loss on any capital invested from the perspective of an investor whose domestic currency is the euro:

## VI.2. Draft guidelines on Materiality

**Guideline 3: Where the materiality is not apparent from the disclosure in the risk factor, the competent authority should challenge the inclusion of the risk factor. Where necessary, the competent authority should request that the persons responsible for the prospectus amend such a risk factor or request a clearer explanation. The competent authority should not approve a prospectus where materiality is not apparent from the disclosure of the risk factor.**

19. If the review of the disclosure in the risk factor contained in a prospectus creates doubt about the materiality of the risk factor, the competent authority should challenge the persons responsible for the prospectus by reference to their responsibilities set out in [Article 6 \(1\) and](#) Article 16 (1) of the Prospectus Regulation.

**Guideline 4: The competent authority should review that the potential negative impact of the risk factor on the issuer/guarantor and/or the securities is disclosed.**

20. Where available, the disclosure of quantitative information, in order to illustrate the potential negative impact of a risk factor should be ~~included-considered~~. ~~However, where quantitative information is not available~~ Otherwise, the description of the potential negative impact of the risk factors may be described using a qualitative approach.
21. For example, in relation to qualitative disclosure, to the extent it is explained how the risk factor affects the issuer or the securities one option for the presentation of the materiality of risk factors may be by reference to the scale of low, medium or high as per Article 16(1) subparagraph 3 of the Prospectus Regulation. However, the persons responsible for the prospectus are not obliged to provide such a scaled ranking of risks according to their materiality. The potential impact of the risk factor needs to be disclosed in any case.

**Guideline 5: Where materiality is compromised by the inclusion of mitigating language the competent authority should challenge the inclusion of such language. Where necessary, the competent authority ~~should~~ can request that the persons responsible for the prospectus to amend the risk factor disclosure in order to remove such mitigating language.**

22. Mitigating language is that which could limit the perception of risk including the impact or the probability of the risk factor occurring to the extent that the reader is not clear whether there is any remaining risk.

23. Where mitigating language is included in relation to a risk factor, it can only be used in relation to illustrate its probability of occurrence and the expected magnitude of its negative impact.
24. The following is an illustration of mitigating language which, when read alone, reduces the materiality of a risk factor and which obscures the remaining risk. The following mitigating language should be amended in order to remove the mitigating language when it compromises the materiality of the risk factor as a whole and in the context of the prospectus:

In the course of its business activities, the Group is exposed to a variety of risks, including credit risk, market risk, liquidity risk and operational risk. Although the Group invests substantial time and effort in risk management strategies and techniques, it might nevertheless fail to manage risk adequately in some circumstances.

### VI.3. Draft guidelines on Corroboration of the materiality and specificity

**Guideline 6: Where the competent authority considers that the materiality and the specificity of a risk factor is not corroborated by a reading of the prospectus, the competent authority should challenge the inclusion of such risk factor. Where necessary, the competent authority should request that the persons responsible for the prospectus amend the relevant risk factor or request an explanation, so as to make it clear why it is specific and material. The competent authority should not approve a prospectus where it is not apparent that materiality and specificity are corroborated.**

25. While direct/clear corroboration of the materiality and specificity of the risk factor is normally may be demonstrated via the inclusion of corresponding information elsewhere in a prospectus, this is not necessary in all circumstances. In certain most cases, it is sufficient that materiality and specificity of risk factors is identifiable by reference to the overall picture of the issuer/guarantor and the securities presented in the prospectus.

### VI.4. Draft guidelines on Presentation of risk factors across categories

**Guideline 7: The presentation of risk factors across categories (depending on their nature) should aid investors in navigating the risk factors section. Where this is not the case, the competent authority should challenge the presentation. Where necessary, the competent authority should request that the persons responsible for the prospectus amend the presentation of risk factors across categories. The competent authority should not approve a prospectus when risk factors are not presented across categories based on their nature.**

26. The categorisation of risk factors and the ordering of risk factors within each category should support their comprehensibility. Both should assist investors in understanding the source and nature of each disclosed risk factor. A risk factor should generally only appear once, in the most appropriate category. However, if necessary, the persons responsible for the prospectus may insert a cross-reference in

each relevant category to the risk factor that is disclosed elsewhere in the prospectus.

27. In accordance with Article 16 of the Prospectus Regulation, the most material risk factors must be presented first in each category, but it is not mandatory that all further risk factors within each category must be ranked in order of their materiality.
28. Risk factors specific and material to the issuer/guarantor could, ~~for~~ by way of non-exhaustive example, be divided into the following categories:
  - o Risks related to the issuer's financial situation;
  - o Risks related to the issuer's business activities and industry;
  - o Legal and regulatory risk;
  - o Internal control risk; and
  - o Environmental, social and governance risks.
29. Risk factors specific and material to the securities could, ~~for~~ by way of non-exhaustive example, be divided into the following categories:
  - o Risks related to the nature of the securities;
  - o Risks related to the underlying;
  - o Risks related to the guarantor and the guarantee; and
  - o Risks related to the offer to the public and/or admission of the securities to trading on a regulated market.

**Guideline 8: The competent authority should ensure that each of the categories are identified within the risk factors section of the prospectus via the use of appropriate headings.**

30. Headings should reflect the nature of the risk factors. When presenting headings it should be ensured that they are easily identifiable in the prospectus, through the use of appropriate spacing and bold font.
31. A category should not be included when it is not relevant. Where a risk factor, or risk factors are similar in nature, they can be arranged and presented under the same heading.

**Guideline 9: The competent authority should ensure that the number of categories included in the prospectus is not disproportionate to the size/complexity of the transaction and risk relating to the issuer/guarantor or the securities.**

32. ESMA considers that including more than ten categories in the case of a standard, single-issuer, single-security prospectus, ~~would~~ may go beyond the requirement in Article 16(1) of the Prospectus Regulation which states that the 'risk factors shall be presented in a 'limited' number of categories". This figure of up to ten categories should be reduced where such a number of categories is not relevant or, in other circumstances, it could be extended if the complexity of the transaction or business of the issuers requires and otherwise depending on the case. ESMA understands

the case of a multi-product base prospectus as an example where further categories may be relevant.

33. Fewer categories should be included where that is all that is necessary to categorise the risk factors in a comprehensible manner.

**Guideline 10: Categories ~~should only~~ may be further divided into sub-categories in cases where sub-categorisation can be justified on the basis of the particular type of prospectus. Competent authorities should challenge the use of sub-categories in the risk factors section in other circumstances.**

34. Sub-categories ~~should only~~ may be used where their inclusion can be justified on the basis of the particular type of prospectus. For example, in the case of a base prospectus containing multiple types of securities, sub-categories might be necessary for the presentation of risk factors.
35. In the event that sub-categories are used, the principles that apply for the presentation of risk factors, as described throughout this sub-section on presentation of risk factors across categories, should apply.

#### **VI.5. Draft guidelines on Focused/concise risk factors**

**Guideline 11: Competent authorities should ensure that the disclosure of each risk factor is presented in a concise form subject to Article 6 (2) of the Prospectus Regulation. Where this principle is not complied with, competent authorities should challenge the wording and request more focused disclosure.**

36. The 'size inflation' of prospectuses (a phenomenon which may also be directly attributable to the inclusion of large quantities of information surrounding each risk factor included in a prospectus) is a matter which should be addressed by competent authorities during the review process.

#### **VI.6. Draft guidelines on Risk factors in the summary**

**Guideline 12: Where a summary has been included in the prospectus, competent authorities should ensure that the order of its presentation of key risks is consistent with the order of the risk factors in the risk factors section.**

37. As the most material risk factors should be described first in each category, the disclosure of the risk factors in the summary (if applicable) should be consistent with the presentation in each category.

<ESMA\_QUESTION\_GRF\_11>