



ESMA Guidelines on risk factors under Prospectus Regulation. June 2019.

Article 16 of 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 (the Regulation) gives the European Securities and Markets Authority (ESMA) a mandate to develop guidelines to *“assist competent authorities in their review of the specificity and materiality of risk factors and of the presentation of risk factors across categories depending on their nature”*.

The aim of the risk factors is to allow investors to assess significant risks related to their investment, thus allowing them to make informed investment decisions. The description of the risk factors must therefore be limited to risks which are material and specific to the issuer and/or its securities, consistent with the content of the prospectus and expressed clearly and concisely. In addition, the information provided in relation to the risks should not be used to mitigate liability for the information contained in the prospectus.

With the aim of assisting competent authorities (CAs) in their review of prospectuses and to facilitate appropriate, concise and comprehensible presentation of the risk factors, ESMA drew up draft guidelines, which it put to public consultation in July 2018. As a result of the consultation, on 29 March 2019 ESMA published a final report containing a summary of the comments made by the industry and ESMA’s response to the issues raised. Although the Guidelines are aimed at CAs, the persons responsible for the prospectus (issuers or their 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) should take them into account when preparing the prospectus.

Once the Guidelines are translated into the official EU languages, they will become effective two months after their publication on ESMA’s website.

The Guidelines and the explanatory text

The draft text contains 12 guidelines relating to the specificity and materiality of the risk factors, corroboration of these aspects in the prospectus, presentation of risk factors across categories, their presentation in a concise manner and their description in the prospectus summary, where one exists.

Guidelines 1 and 2, relating to specificity, establish (1) that the specificity of the risk factor must be clearly expressed in the prospectus (there must be a direct link between the risk factor and the issuer, guarantor or securities) and (2) that the CA should challenge the inclusion of factors that only serve as disclaimers.

Guidelines 3, 4 and 5 address the materiality of the risk factor. Specifically, (3) this must be clearly expressed in the prospectus, (4) the CA can question the prospectus when it observes that a potential negative impact of the risk factor on the issuer/guarantor and/or the securities is not disclosed (where available, quantitative information should be used to express it, or otherwise, qualitative information) and (5) the description of

materiality should not be compromised by the use of mitigating language (this language may be used to illustrate the probability of occurrence and expected magnitude of the negative impact, but it must not be confusing for the reader in a manner that prevents him/her correctly assessing the scope of the risk).

Guideline 6 establishes that the CA must ensure that the materiality and the specificity of a risk factor are corroborated by the general image offered in the prospectus.

Guidelines 7, 8, 9 and 10 address the presentation of risk factors across categories. (7) The presentation of risk factors across categories depending on their nature should aid investors navigating the risk factors section (i.e., supporting comprehensibility, which includes mentioning the most material risk factors first). For information purposes, examples of risk factor categories are provided relating to the issuer/guarantor (financial situation, business activity, legal risk, internal control risk and environmental, social and governance factors), as well as relating to the securities (nature, underlying, guarantor and guarantee and offer to the public and/or admission of the securities to trading on a regulated market). (8) Categories should be identified within the risk factors section via the use of appropriate headings (they must be easily identifiable). (9) The CA should ensure that the number of categories and sub-categories included in the prospectus is not disproportionate to the size and complexity of the transaction and risk to the issuer/guarantor (in the case of a standard, single-issuer, single-security prospectus, there should be no more than ten categories and sub-categories). (10) Sub-categories should only be used where necessary (e.g. in the case of a base prospectus containing multiple types of securities).

Guideline 11 stresses the need for risk factors to be presented in a concise manner. The use of excessively long texts may hinder understanding of the prospectus.

Guideline 12 indicates that, where a summary has been included in the prospectus, presentation of risk factors in said summary must be consistent with their presentation, based on materiality, in the risks section.

The Guidelines also have an annex that includes examples of specific and material risk factors for information purposes.

ESMA responds to the issues raised by the industry

The final report makes an analysis of the issues and doubts the proposed wording has generated in the sector and provides a series of clarifications by ESMA. These comments have also been taken into account and, where considered appropriate, modifications have been made to the Guidelines or the explanatory text to make them more understandable. In this regard, it is useful to summarise the main messages that ESMA has decided to issue to the industry with regard to the content of these Guidelines and their purpose, which are in response both to the general comments about the Guidelines and those included in the responses to specific issues raised in the public consultation:

General issues relating to the Guidelines

- In the case of international offerings and the use of EU prospectuses beyond the EU, asymmetries in approval of these documents by non-EU jurisdictions may arise both with regard to the risk factors and other elements of the prospectus, but ESMA is only responsible for applying European legislation and issues concerning other jurisdictions fall outside its remit.
- Although CAs may take into account the addressees of the prospectus when questioning its content, it should not be forgotten that Article 16(1) of the Regulation applies to all prospectuses, irrespective of to whom they are addressed.
- The Guidelines do not create any additional obligations, they simply clarify the provisions in level 1.

On specificity (guidelines 1 and 2)

- There may be similar risk descriptions in the case of issuers belonging to the same industry or for securities of the same type. However, similar risks may affect them in different ways, and it is therefore important for them to include the specificity. The same applies to the re-use of descriptions in other previously approved documents, which may be used providing they remain relevant and are in line with the specific situation of the issuer or security that must be included in the prospectus.

On materiality (Guideline 3)

- Although CAs must ensure (1) that the description of the risks contained in the prospectuses clearly expresses their specificity and materiality, (2) that these are corroborated by the content of the prospectus and (3) that they question the descriptions that are not comprehensible and do not adequately illustrate the circumstances, it is ultimately the persons responsible for the prospectus who must decide which material and specific factors to include.

On illustrating materiality by using quantitative or qualitative information (Guideline 4)

- Quantitative information should be included where this is available in previously published documents and it is appropriate to include it in order to illustrate the potential negative impacts and materiality of the risk factors.

- However, a qualitative scale (low, medium or higher) may also be used, with the person responsible for the prospectus assessing the materiality of the factor. The CA shall only verify that the information is clearly expressed.

On materiality and the use of mitigating language (Guideline 5)

- The description of risk mitigation and management techniques should not completely undermine its materiality, giving the impression that the risk does not exist or is not material, as if it is not material it should not be included. Persons responsible for preparing the prospectus must keep a balance in order to ensure that the mitigating language helps to prevent a risk being overestimated, while at the same time ensuring that it is not underestimated. This is the criterion that CAs will have to take into account when reviewing the information.

On corroboration of the materiality and specificity in the content of the directive (Guideline 6)

- Corroboration of the risk factors in the content of the prospectus is linked to the principle of consistency (Article 20 of the Regulation). In the event of a divergence in application of these Guidelines by the CAs, ESMA would provide clarifications. It bears repeating that CAs will simply request that the information be expressed clearly or for it to be demonstrated how a risk factor fits within the overall picture of a prospectus.

On presentation of risk factors across categories (Guidelines 7, 8 and 10)

- Although a risk may belong to several risk categories included in the prospectus, it should only appear in the most appropriate category. Similarly, the use of cross-references of risks in different categories is considered to hinder the comprehensibility of the text.

- In each category, the most material risk factors will be mentioned first on the basis of the assessment made by the persons responsible for the prospectus. The Guidelines do not go beyond level I content and do not suggest an additional sequential order.

On the number of categories and sub-categories (Guideline 9)

- The Guidelines will not limit the use of categories to a particular type of prospectus, as proposed in the first draft. However, given that the Regulation provides that the number of categories should be limited, it does not seem reasonable to use sub-categories in order to undermine this principle. The numerical restriction of ten

categories is flexible. CAs should make a case-by-case assessment of whether the number might be above or below ten.

On concise presentation of risk factors (Guideline 11)

- Descriptions of risk factors must be concise; the use of additional text should not obscure the comprehensibility of the risk. However, CAs shall perform a case-by-case assessment, bearing in mind the principle of proportionality.

On the description of risk factors in the summary (Guideline 12)

- CAs must verify that the order of presentation of the risk factors in the prospectus summary is consistent with their presentation in the body of the prospectus.

Link of interest:

[Final Report on ESMA Guidelines on risk factors under the Prospectus Regulation](#)