

# Final Report

## ESMA Guidelines on risk factors under the Prospectus Regulation



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## Acronyms and definitions

BRRD / Bank Recovery and Resolution Directive	Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council
Commission or EC	European Commission
Consultation Paper	Consultation Paper: Guidelines on risk factors under the Prospectus Regulation (ESMA31-62-996)13 July 2018.
ESMA	European Securities and Markets Authority
NCA or Competent Authority	An authority designated under Article 31 of the Prospectus Regulation
Prospectus Directive (PD)	Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC
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.

Issuer	Issuer as defined in Article 2 (h) of the Prospectus Regulation.
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.
URD	Universal registration document as defined in Article 9 of the Prospectus Regulation
RD	Registration Document

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## 1. Executive summary

### Reasons for publication

Regulation (EU) 2017/1129 of the European Parliament and of the Council 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 was published in the Official Journal of the European Union on 30 June 2017.

Under Article 16(4) of the Prospectus Regulation ESMA is given 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.

ESMA published a Consultation Paper on 13 July, 2018, containing draft guidelines on risk factors which NCAs should incorporate as part of their review practices when scrutinising and approving a prospectus following the full implementation of the Prospectus Regulation, in July 2019. This Final Report provides an overview of the feedback received from stakeholders during the public consultation as well as ESMA's responses to the various points raised. The final guidelines which are presented in Annex II take into account the comments and suggestions raised by respondents.

### Contents

This Final Report contains a number of sections as well as a number of annexes. In order to facilitate the reader, the principal sections are explained as follows:

Section 3 entitled 'General remarks about this final report' provides some narrative explanations about how and why these guidelines were prepared and to whom they are addressed.

Section 4 entitled 'Feedback statement' contains summaries of the feedback received from the market in respect of each question set out in the Consultation Paper. Each of these aforementioned summaries is accompanied by an ESMA response. In addition to the responses to specific questions in the Consultation Paper, ESMA received many overall comments to the draft guidelines on risk factors. These overall comments can be read at the outset of section 4.

There are two annexes to this paper: Annex I contains the list of financial market participants who responded to the paper; Annex II contains the final text of the guidelines on risk factors and their explanatory text.

### Next Steps

The final guidelines in Annex II will be translated into the official EU languages and published on ESMA's website. They will become effective two months after their publication on ESMA's website in all the official languages.

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## **2. Introduction**

### **2.1. Mandate**

1. 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 was published in the Official Journal of the European Union on 30 June 2017.
2. Under Article 16(4) PR, ESMA is mandated 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.

### **2.2. General**

3. Under the Prospectus Directive regime risk factor disclosure has often been used by persons responsible for the prospectus as a way to mitigate liability for the information contained in a prospectus, without necessarily providing clear and concise explanations of the risks which are inherent to a particular issuer or security. Risk factors have often been particularly difficult for retail investors to comprehend owing to, among other things, regular inclusion of vague or generic language, as well as legal jargon or mitigating language such as lengthy descriptions of risk management policies.
4. The Prospectus Regulation is unequivocal in terms of seeking to influence a change of course when it comes to preparing risk factor disclosure and focuses on the importance of the quality and clarity of risk factor disclosure. The anticipated outcome of this legislative steer is that it will prevent a recurrence of risk factors serving uniquely as disclaimers; but instead as a key source of pertinent information for investors. Recital 54 of the PR typifies this anticipated shift and states that the primary purpose of including risk factors in a prospectus is to ensure that investors can make an informed assessment of risks and thus take investment decisions in full knowledge of the facts. The same recital continues by adding that risk factors should therefore be limited to those risks which are material and specific to the issuer (and/or the guarantor, if applicable) and its securities, and which are corroborated by the content of the prospectus. More broadly, Recital 27 explains that a prospectus should not contain information which is not material or specific to the issuer and the securities concerned, as that could obscure the information relevant to the investment decision and thus undermine investor protection.
5. The legislative position is firmly set out in Article 16 of the PR. In Article 16(1) key principles are prescribed to persons responsible for the prospectus. In Article 16(4) ESMA is given a mandate to develop guidelines which are to assist NCAs in their review of risk factors prepared by the former parties. While the keystone upon which these guidelines have been developed is indeed the PR mandate, it is important to recall that a peer review conducted by ESMA, in 2016, on the supervision of prospectuses identified, among other things, that use of mitigating language was a problem area for NCAs reviewing risk factors. As this

issue is intrinsically linked with the mandate included in the PR for risk factors, ESMA decided to also address this issue in these guidelines.

6. ESMA welcomed the support expressed by financial market participants for the draft guidelines contained in the Consultation Paper. While ESMA acknowledged that some market participants were concerned about the impact of the guidelines on existing practices, it is important to remind all stakeholders of the clear indication in the Prospectus Regulation for risk factor disclosure practices to change. This final report provides an overview of the feedback received from the market and contains ESMA's responses to the various points raised. ESMA outlines its rationale for certain positions, or for any amendments to the final guidelines in those responses.
7. Lastly, although these guidelines are directly addressed to NCAs, it was important to publicly consult on their content given that persons responsible for preparing risk factors should take them into account before submitting prospectuses for approval. ESMA hopes that these guidelines will serve as an effective but flexible tool in building on the Prospectus Regulation's vision of ensuring that prospectus risk factor disclosure is presented in an easily analysable, concise and comprehensible form.

### 3. Feedback Statement

8. This section provides a summary of the responses to the Consultation Paper which was published in July 2018. Each summary focuses on key points and the general issues raised in response to the questions contained in the Consultation Paper. Each summary is followed by an ESMA response.

#### 3.1. General comments to the draft guidelines contained in the Consultation Paper

Banking	Investment Services	Legal and Accountancy	Issuers	Regulated Market	Other	Government, Regulatory and Enforcement
4	1	2	5	2	2	0

9. There were 16 responses containing general comments on the draft guidelines set out in the Consultation Paper. These general comments were often repeated in response to more specific questions in the Consultation Paper. A further 21 responses were provided in relation to question ten but, as the bulk of the feedback to question ten was similar to the feedback provided in the general comments, ESMA has summarised both question ten feedback and the general feedback in the following paragraphs. This is in order to avoid unnecessary repetition.

10. ESMA welcomed the general support of many respondents for the draft guidelines. Certain comments showed that financial market participants acknowledged ESMA's intention to ensure a balance between flexibility and robustness. A smaller minority of respondents felt that ESMA's draft guidelines were a little too detailed and that it was important for the guidelines to allow a certain level of scope for persons responsible for a prospectus to continue drafting some form of generic risk factors in certain circumstances. A number of respondents cautioned against the inclusion of language which indicates that NCAs should challenge disclosure of risk factors and did not agree that NCAs should be instructed to 'not approve a prospectus'. While these points were recurring, most respondents did not raise them in relation to any particular question.
11. The following points aim to highlight some of the principal recurring comments throughout the general responses:
- A) It was questioned whether ESMA has a mandate to include wording in a guideline which suggests that NCAs should not approve a prospectus and it was stated that such a sentence should not be included in a level III measure. Given that persons responsible for the prospectus are liable for its content there would be a serious liability risk for those parties if they are forced to remove a risk factor following an NCA's assessment of materiality;
  - B) Encouraging NCAs to 'challenge the inclusion of a risk factor' was argued to be problematic given the subjectivity of assessments by NCAs. One participant who raised this point suggested that the review of risk factors should only focus on the qualitative features of the disclosure and should not go beyond that. In order to illustrate the practical problem envisaged by this particular respondent, an example of a prospectus for structured products was used. The respondent stated that the focus of the challenge should not be related to the merits, or any lack thereof, of issuing structured products, but only on the qualities of the disclosure;
  - C) Some respondents stated that the draft guidelines grant NCAs a great degree of discretion to request amendments to disclosure, to challenge the inclusion of risk factors and to not approve prospectuses. These respondents felt that such a level of subjective discretion could ultimately lead to forum shopping and to an increase in the requirements for accessing the capital markets. It was stated that persons responsible for the prospectus are responsible for assessing which risk factors should be included in accordance with Article 16 PR and, as such, there must be a balance between NCA's powers and the powers of those responsible for drawing up a prospectus to determine what is appropriate to disclose in the risk factor section. Given that the latter parties are liable to investors for the content of the prospectus, it was emphasised that the final decision for what is included and presented in the risk factors section rests with them;
  - D) Some respondents stated that prospectuses which are used outside the EU may be scrutinised differently and could also require detailed explanations, for example of EU

Regulations. Those who raised this point stated that European issuers cannot adapt the wording of their risk factors for both intra EU and external use of prospectuses;

- E) In the context of large international offerings of securities, some raised concerns over the potential for investor actions being taken in a number of jurisdictions. Therefore, those liable for the content of the prospectus would now have to take a very conservative approach when deciding what risk factor disclosure to include;
- F) A number of respondents called for the category of end-investor to be taken into account when NCAs apply these guidelines. A more flexible approach should be applied when reviewing risk factors in a prospectus aimed at wholesale investors rather than retail investors; and
- G) The flexibility envisaged by ESMA is welcome and must be applied by NCAs. This flexibility is warranted given that each prospectus should be treated on its own merits, particularly when taking into account factors such as the addressees of a prospectus, e.g. wholesale or retail investors or the complexity of the products being issued. As such, the final guidelines should provide scope to reflect practical realities and should not be applied stringently simply as a matter of procedure.

12. The following additional points were made, however, as these points were also raised in respect of more specific questions, ESMA has provided a response to these points under those specific question headings:

- H) Similar disclosure should be allowed for issuers operating within the same particular industry or where the risk factors relate to similar types of securities;
- I) Disclosure of risk factors in a prospectus should be consistent with disclosure of risk factors in underlying financial reports;
- J) Risk mitigation techniques should not be prevented from being disclosed within the risk factors section; and
- K) The PR does not require quantitative disclosure, therefore the guidelines should not refer to it.

*ESMA's response:*

13. When preparing the final guidelines ESMA has taken the feedback into account and where necessary has amended the guidelines or included explanatory text to provide more guidance to NCAs when they are reviewing risk factors included in prospectuses. In addition, ESMA has aimed to provide clarifications and answers in respect of frequently recurring points raised by financial market participants.

14. Beginning with the points raised in A to C, which were also raised in response to various questions contained in the Consultation Paper, ESMA's position and views outlined in paragraphs [17-20] can be viewed as a catch-all response.
15. ESMA has slightly changed the final guidelines in order to remove references to non-approval of prospectuses in cases where the materiality or specificity of a risk factor is unclear. Nevertheless, ESMA intends that the revised language should achieve the same result, which is to ensure that the disclosure of risk factors complies with Article 16(1) PR. ESMA notes that the PR requires that '[...] the risk factors featured in a prospectus shall be limited to risks which are specific to the issuer and/or to the securities and which are material for taking an informed investment decision [...]'. Therefore, NCAs should use the powers conferred upon them in accordance with Article 20 of the PR, to ensure that the provisions set out in the PR are applied, i.e. when approving a prospectus, NCAs should ensure that the persons responsible for the prospectus comply with Article 16(1).
16. Article 20(5) provides NCAs with the necessary powers to refuse the approval of a prospectus and terminate the review process 'Where the issuer, the offeror or the person asking for admission to trading on a regulated market is unable or unwilling to make the necessary changes or to provide the supplementary information requested [...]'. Therefore, NCAs may use the powers conferred upon them in Article 20(5) of the PR in a situation where the persons responsible for the prospectus are unable or unwilling to demonstrate why a given risk factor is material and specific. In ESMA's view, this approach is fully consistent with the intention of the legislator when limiting the disclosure of risk factors to those which are material, specific and corroborated. ESMA believes that the process of approving prospectuses, in general, and risk factors, in particular, is an interactive discussion between the NCA and the persons responsible for the prospectus. As such, ESMA has included explanatory text in the background section of the guidelines (Section V) to provide guidance to NCAs and market participants about how this process should be conducted.
17. NCAs are not required to assess the materiality of a risk factor, the materiality assessment remains the responsibility of the persons responsible for the prospectus. Those persons should ensure that the disclosure clearly illustrates the materiality (and specificity) of the risk. NCAs only have to ensure that the materiality (and specificity) is apparent from the disclosure and therefore it is only the quality and comprehensibility of the disclosure which the NCA will review. When assessing the quality and comprehensibility of the disclosure, NCAs should check if it is comprehensible, consistent and complete, as per Article 20 of the PR.
18. Article 16(1) of the PR sets out a materiality test addressed to those responsible for drawing up a prospectus with explicit criteria. These criteria should be considered by any persons responsible for the prospectus when deciding which risk factors to include in a prospectus, therefore it is clear that the final decision of which factors to include remains with those persons responsible. NCAs should ask for the disclosure in a prospectus to be clearer if it is unclear why a risk factor was included based on these criteria.

19. As for points D and E and the future concerns surrounding international offerings and the use of EU prospectuses beyond Europe, this is not something ESMA can address. There is a clear steer at European level (explicitly referred to by the legislator) for a change of direction and the inclusion of more pertinent and focused disclosure in risk factors contained in EU prospectuses; ESMA's mandate is simply to contribute to this new direction. ESMA would also like to highlight the fact that disclosure requirement asymmetries are not exclusively related to risk factor disclosure where offering documents are approved in non-EU jurisdictions. The Prospectus Regulation may require more information to be disclosed or presented in a different way, in other parts of a prospectus, as compared to legislation in other jurisdictions or vice versa.
20. Lastly, in relation to points F and G, ESMA believes that the comprehensibility of risk factors in a prospectus is key to providing effective disclosure. An NCAs' analysis of comprehensibility may be influenced by factors such as an issuer being new to the market or an offering of securities targeting retail investors. After having paid particular attention to the points raised concerning comprehensibility and the category of investor to whom an offer is addressed, ESMA included in the background section of the final guidelines (Section V) a reference to the fact that NCAs may take into account the addressees of the prospectus when challenging the disclosure. Nevertheless, ESMA notes that Article 16 (1) of the Prospectus Regulation applies to all prospectuses, therefore, the persons responsible for the prospectus must always ensure that risk factors are material and specific and that they are corroborated by the content of the prospectus.

### 3.2. Responses to the questions in the Consultation Paper

**Question 1: Do you agree with the suggested draft guidelines on specificity? If not, please provide your reasoning.**

Banking	Investment Services	Legal and Accountancy	Issuers	Regulated Market	Other	Government, Regulatory and Enforcement
7	3	3	7	2	2	1

21. There were 25 responses to question one set out in the Consultation Paper.
22. Most respondents were broadly in agreement with the direction of the guidelines on specificity and their general objective. However, there were a number of points raised which indicated that certain clarifications are needed in order for market participants to understand what NCAs will be expecting when applying these guidelines and what they should be permitting in terms of re-use of similar or existing disclosure.
23. A significant number of respondents wanted clarification in relation to the use of similar types of disclosure in risk factors relating to issuers operating in the same industry or

disclosure relating to similar types of securities. For example, risk factors often address geopolitical events, the economic environment or legislative changes, etc. As such, financial market participants questioned if NCAs are going to continue allowing these types of risks to be construed as specific to the issuer or will NCAs be looking for tailored disclosure to the extent that the use of similar disclosure will not be permitted.

24. In addition to the questions raised concerning similar disclosure being used by issuers operating in a specific industry or in relation to similar securities, the market also sought clarifications on the re-use of disclosure contained in previously approved regulated documents such as audited financial statements. One respondent cited the principle of 'better regulation' and the call for evidence on coherence and consistency of EU financial markets regulation and highlighted that information asymmetries should be avoided. Another respondent used a very specific example to illustrate the broader issue. This example concerned the use of approved and filed guarantor disclosure where the guarantor acts in the context of several issuances via SPVs. That respondent asked how risk disclosure related to the guarantor would be treated in respect of securities issued under base prospectuses approved by different NCAs. The respondent believed that the disclosure concerning risks related to the guarantor should not be subject to individual discussions in the approval process between the SPV and its NCA and that the content of risk disclosure, once it has been filed and approved once, by the guarantor's NCA, should suffice. The specific example used to a greater or lesser extent emphasised the general theme of these inquiries.
25. Although the general objectives behind the draft guidelines on specificity were commonly supported, i.e. preventing the use of generic risk factors, one respondent emphasised, by way of example, a need for proportionality in the application of these guidelines. This particular respondent stated that the NCA's review and application of the specificity guidelines should not result in the obligation for issuers to disclose details such as trade secrets. Overall, this general call for proportionality appeared throughout the responses to most questions.
26. While some respondents believed that the use of examples was helpful in providing an indication of what the expected outcomes would be from an NCA applying the guidelines, these respondents were concerned that the examples would be viewed as template disclosure or as an illustration of the analyses that are appropriate in all contexts.

*ESMA's response:*

27. ESMA accepts that similar risk factor disclosure can be used where it concerns issuers operating within the same industry or securities of the same type. However, ESMA also notes that similar risks may affect issuers differently; therefore, what is of fundamental importance is that the disclosure of risk factors clearly illustrates the specificity of that risk to a particular issuer or security. For example, the size or market share of an issuer operating in a given industry might leave it disproportionately exposed to a risk in comparison to others within the same sector. Consequently, NCAs are being instructed to look for the details which customise the risk factor and move it away from the framework of non-specificity.

28. In relation to the re-use of disclosure contained in previously approved regulated documents and the need to avoid information asymmetries the same principle as expressed in the paragraph above applies: NCAs are not being asked to reject similar disclosure. As a general principle, disclosure in regulated documents is allowed only to the extent it complies with the final guidelines. NCAs are being encouraged to engage with the persons responsible for the prospectus and to ask why re-used risk factor disclosure, which has been copied verbatim from another document, is still relevant to the particular issuer or security where this is not otherwise clear from the prospectus. For example, the risk factor disclosure related to a guarantor in a first prospectus may be as equally relevant in a third prospectus, but the disclosure of the risk factor of the guarantor in the third prospectus might need to be adapted (further specified) to reflect if other guarantees have been previously provided by the same guarantor and thus the investor's exposure to risks has changed. In order to clarify what is expected from NCAs when assessing the specificity of risk factors when issuers operate in same industry or the securities seem to be exposed to similar risks, ESMA has included additional explanatory material.
29. While the goal of the PR to bring about change in relation to risk factor disclosure is clear, the application of these final guidelines should not become disproportionate in practice. ESMA has at no point intended for these guidelines to be used in a manner which would lead to a situation such as forcing an issuer to disclose a material trade secret. ESMA notes that the PR already addresses confidentiality/omission of information in Article 18. Where persons responsible for the prospectus consider that the disclosure of information would place the issuer at a commercial disadvantage they should engage with NCAs, during the approval process of the prospectus, to demonstrate that the disclosure of certain information is seriously detrimental to them or to the guarantor. As this topic is dealt with directly in the PR, ESMA believes that it is not necessary to incorporate this into the guidelines or into its explanatory material.
30. ESMA also made adjustments to the wording used in guideline 1 and guideline 2 to ensure that its content does not overlap. While guideline 1 will deal with specificity in general, guideline 2 refers now to the inclusion of disclaimers or language which could be considered similar to disclaimers. As also referred to in the recitals of the PR, risk factors section should not include such language as this may undermine the comprehensibility and may obscure the specificity and materiality of risk factors.
31. In relation to the examples that were contained in the Consultation Paper, ESMA has considered the possibility that these might be used literally. As they are only for illustrative purposes, they have now been moved to Appendix I of the final guidelines contained at the end of this report.

**Question 2: Do you agree with the suggested draft guideline 3? If not, please provide your reasoning.**

Banking	Investment Services	Legal and Accountancy	Issuers	Regulated Market	Other	Government, Regulatory and Enforcement
7	3	3	7	2	1	1

32. There were 24 responses to question two set out in the Consultation Paper.
33. The feedback to question two was limited to a small number of recurring points. These recurring points not only surfaced in the responses to question two, but also in the general comments to the guidelines. While the principal comments have already been summarised under the heading ‘General comments to the guidelines [...]’, ESMA will briefly reiterate elements of them here, in addition to referring to some of the supplementary points raised uniquely in response to this question.
34. The language contained in guideline 3 which states that NCAs ‘should not approve a prospectus’ proved to be the most contentious point in relation to these guidelines. Respondents’ primary concerns were that the draft guideline gives the impression that NCAs, as opposed to persons responsible for the prospectus, will somehow be making materiality assessments. Respondents raised liability concerns and indicated that if a risk factor is removed following a ‘subjective assessment of materiality’ by an NCA, then the persons responsible for the prospectus could be exposed to considerable risks if such a risk ultimately materialised but was not disclosed. A small number of respondents flagged further issues by stating that EU prospectus liability regimes are not harmonised and therefore differing assessments between Member States of materiality and any associated removal of risk factors could be problematic.
35. Adding to the points made in the paragraph above, one respondent went so far as to question if the NCA ‘will accept to take responsibility of this decision to remove a risk factor vis-à-vis the investors in case of litigation, especially if the risk finally occurs’. A number of respondents suggested, particularly in respect of the issue concerning the absence of harmonised prospectus liability regimes, that the final guidelines should be amended to indicate that NCAs should explain the rationale behind their opinions and that persons responsible should have the possibility to contest the rationale of the NCA. It was further suggested that exchanges of opinions between persons responsible for the prospectus and NCAs should be filed in the prospectus approval process records to appropriately document the discussions.
36. Many respondents questioned the reference to the IFRS definition of ‘materiality’ contained in the Consultation Paper. Some respondents pointed out that, while there is no

definition of materiality in the Prospectus Regulation, Article 16 (1) sets out the relevant criteria from which such a definition of materiality can be extrapolated.

*ESMA's Response:*

37. As for the points concerning the non-approval of prospectuses and the belief that materiality assessments are somehow being transferred onto NCAs, ESMA would like to reiterate its responses to bullet-points A to C set out in the section entitled 'General comments to the guidelines [...]'. For ease those ESMA responses were as follows:

*'NCAs are not required to assess the materiality of a risk factor, the materiality assessment of risks remain the responsibility of the persons responsible for the prospectus. Those persons should ensure that the disclosure of the risk factor clearly demonstrates that the risk is material and specific. NCAs only have to ensure that the materiality of the risk factor is apparent from the disclosure and therefore it is only the quality or clarity of the disclosure which the NCA will review.'*

*'Article 16(1) of the PR sets out a materiality test addressed to those responsible for drawing up a prospectus with objective criteria. These objective criteria serve as the basis for an issuer's decision to include whichever risk factor they choose. However, if it is not clear why a risk factor was included based on such criteria, then an NCA should be asking for the disclosure to be clearer in that regard.'*

38. NCAs will not be making materiality assessments or asking persons responsible for the prospectus to remove risk factors simply due to the fact that an NCA does not consider a risk factor to be material. Materiality is to be determined by the issuer in accordance with Article 16 of the PR. NCAs should only make comments relating to the fact that the materiality of the risk factor is unclear from the disclosure in the prospectus.
39. As for the point concerning different EU prospectus liability regimes, ESMA would like to again refer to the fact that NCAs will not be making different assessments of materiality and will only be looking at the quality and comprehensibility of the disclosure. The final guidelines now contain clarifications which describe the steps that NCAs should take where the materiality of a risk factor is not evident to them from the descriptions. These clarifications require dialogue between the relevant NCA and the persons responsible for the prospectus. When assessing the quality and comprehensibility of the disclosure, NCAs should check if it is comprehensible, consistent and complete, as per Article 20 of the PR.
40. In relation to the comments concerning the IFRS definition of materiality, ESMA notes that this appears to have created some confusion for the market, but stresses that it was only contained in the Consultation Paper and not the proposed draft legal or explanatory text to the draft guidelines. There will be no further references to it in the final report nor in the final guidelines. While it is indeed true that there is no definition of materiality set out in the Prospectus Regulation, the criteria in Article 16(1) are the criteria which ESMA considers most relevant when considering the concept of materiality.

**Question 3: Do you agree with the suggested draft guideline 4 on quantitative information? If not, please provide your reasoning.**

Banking	Investment Services	Legal and Accountancy	Issuers	Regulated Market	Other	Government, Regulatory and Enforcement
7	3	3	7	2	2	1

41. There were 25 responses to question three set out in the Consultation Paper.
42. Several respondents expressed concern in relation to draft guideline 4 and its accompanying explanatory text. One recurring comment was that Article 16 of the Prospectus Regulation contains no obligation to include quantitative information on the potential impacts of the risks disclosed in the risk factors section. Therefore, to certain respondents at least, this draft guideline appeared to go beyond the requirements of level I. In terms of the type of quantitative information to be disclosed, there were a number of requests for clarifications regarding what ESMA envisaged, i.e. would it be information contained in financial statements and prepared in accordance with IFRS, or other quantitative (financial) information?
43. Additionally, a small number of respondents were concerned about the utility and practical application of such quantitative measures as a benchmark for determining risk. These respondents felt that the use of quantitative measures could lead to confusion from an investor's perspective. Furthermore, these respondents believe that the production of quantitative information might require issuers to produce methodologies and assumptions within prospectuses, which may not be workable in the context of certain document types such as base prospectuses.
44. Many respondents believed that the explanatory text following draft guideline 4 created a hierarchy between quantitative and qualitative information which does not exist in level I. Some respondents believe that the explanatory text seemed to suggest that if quantitative information is available, then it should always be included and that persons responsible for the prospectus did not have the option to use qualitative descriptions in such circumstances. These respondents feared that NCAs might make it a default approach to require such quantitative information.
45. One respondent requested a more general clarification from ESMA by direct reference to the qualitative scale of low, medium or high set out in level I. That particular respondent queried the scope of the NCAs review and questioned whether an NCA can disagree with an issuer's assessment of the gravity of negative impact or materiality of the risk. This question appeared to be very much aligned with the general comments raised on the draft guidelines on risk factors concerning whether NCAs will be responsible for the materiality assessment and specificity assessment.

*ESMA's Response:*

46. While the draft guideline appeared to create the impression that there is an obligatory requirement for quantitative information, this was not ESMA's intention. However, while ESMA remains firmly convinced that potential negative impact and materiality of risk factors is better illustrated when risk factor disclosure includes quantitative information, ESMA acknowledges that including quantitative information may not be possible in all cases and persons responsible for the prospectus should not be required to produce such information where it is unavailable or inappropriate to include.
47. The final guidelines clarify that where quantitative information is available in previously published documents (e.g. in IFRS financial statements, management reports) and where it is appropriate to include, persons responsible for the prospectus should include it to illustrate the potential negative impact.
48. The production of qualitative information, as a means to demonstrate potential negative impact, is also possible and, as such, persons responsible for a prospectus may use a qualitative scale. As for the comment from one respondent which called into question the general assessment of the materiality of risk factors by NCAs vis-à-vis this scale of low, medium or high set out in level I, ESMA reconfirms that it is for the persons responsible for the prospectus to assess the materiality of a risk factor and not the NCA. The NCA will only look at the quality of the disclosure.

**Question 4: Do you agree with the suggested draft guideline 5 on mitigating language? If not, please provide your reasoning.**

Banking	Investment Services	Legal and Accountancy	Issuers	Regulated Market	Other	Government, Regulatory and Enforcement
7	3	2	7	2	2	1

49. There were 24 responses to question four set out in the Consultation Paper.
50. The majority of respondents were supportive of the draft guideline on mitigating language. However, a number of respondents felt that the example provided in the explanatory text was not very helpful and that it could possibly be taken out of context by NCAs and applied literally, to such an extent that any mitigating language would not be permissible in a prospectus.
51. It was unclear according to many responses whether the draft guidelines intended to prohibit all use of mitigating language; those raising the point questioned if such a total prohibition applied to descriptions of risk management practices and also to general descriptions of risk mitigation techniques. To illustrate some practical concerns, certain respondents highlighted circumstances where they would consider it appropriate to cross-reference to risk management disclosure contained in other regulated documents which

contain these descriptions. Two respondents pointed to the case of IFRS 7, in the context of risks linked to financial instruments, where persons responsible for the prospectus could cross-refer to information contained in notes to the financial statements. In accordance with IFRS 7, issuers are required to disclose information about management's objectives, policies and processes for managing those risks. This example broadly illustrated the crux of the problem for those who were unclear about whether the draft guidelines were intended to go as far as prohibiting the use of such language.

52. One respondent provided an alternative approach to explaining why mitigating language should be permitted. That respondent considered that mitigating language may also prevent over-estimation of risk and is therefore a useful tool in enabling investors to reach an informed investment decision.

*ESMA's response:*

53. ESMA welcomed the support for the inclusion of a draft guideline on mitigating language. As for the example, ESMA's intention is to retain it, but it will be placed in Appendix I of the final guidelines. It should only serve as an example and should not be applied literally. Its purpose is illustrative and there is no intention for it to be used to prevent any use of mitigating language.
54. General descriptions of risk mitigation techniques or risk management practices are not proscribed provided that use of such mitigating language does not completely undermine the materiality of a risk factor by giving the impression that there is no longer any risk present. NCAs are expected to review mitigating language from this perspective and they are also expected to consider whether the length of mitigating language obfuscates the negative effect on the issuer or the securities.
55. Where risk management policies are in place, before including risk factors in a prospectus or cross-referring to the risk policy management description, persons responsible for the prospectus should reassess if the risk described remains material. NCAs may request a confirmation that the risk factor remains material given the risk management policies that may be in place. Where the risk management policy disclosure gives the impression that the risk is no longer material then the mitigating language should be removed or amended, or the risk factor should be deleted. If a cross-reference is included and its content similarly undermines the significance of a risk then the NCA may request that the materiality of the risk is made clear in the prospectus and/or the cross-reference to be removed.
56. The submission from one respondent which presented an alternative way to view the use of mitigating language was indeed very helpful and to an extent captures part of ESMA's rationale as to why mitigating language is not proscribed. In ESMA's view mitigating language serves an additional and beneficial purpose of ensuring that prospectus risk factor disclosure is not overstated to such an extent that it would unnecessarily deter prospective investors. ESMA's approach, when preparing the draft and final guidelines, has been to try and strike a balance which ensures that risk factor disclosure allows the investor to correctly assess the risks.

57. In order to ensure that NCAs have a common supervisory approach regarding the use of mitigating language, ESMA provided explanatory material in order to illustrate how and when the NCA should act when such language is included in the risk factors.

**Question 5: Do you agree with the suggested draft guideline 6 on corroboration of specificity and materiality? If not, please provide your reasoning.**

Banking	Investment Services	Legal and Accountancy	Issuers	Regulated Market	Other	Government, Regulatory and Enforcement
7	3	2	7	2	2	1

58. There were 24 responses to question five set out in the Consultation Paper.

59. The feedback in relation to question five was quite mixed. One respondent raised questions about the mandate and whether it was within ESMA's remit to produce such a guideline, whereas the majority of respondents were supportive of the inclusion of this draft guideline as a whole. However, despite broad support, many were concerned about how the guideline would be applied in practice and the results which this would yield. Ultimately, those seeking clarity believed that persons responsible for the prospectus should not, in all circumstances, be required to corroborate a risk expressly and that it should be accepted that corroboration is attainable by reference to the overall picture of the prospectus. The questions over the future application of this draft guideline therefore primarily concerned whether NCAs would be instructed to take a literal versus holistic approach, with more costly outcomes foreseen in respect of the former.

60. The responses to this question repeated a matter, which had previously been raised in the context of reviewing materiality, concerning differing prospectus liability regimes throughout Member States. The key concerns were again linked to the subjectivity of NCA assessments and the potential for increased risk of prospectus liability, in another Member State, as a result of another NCA having a different view of the sufficiency of corroboration.

61. A small number of respondents had very specific concerns surrounding the use a URD and how the draft guideline would apply in this context. Their concerns were that it would be too burdensome and time-consuming to update URDs with greater frequency than at present. Those market participants considered it of utmost importance that the materiality and specificity of a risk factor should be identifiable by reference to the overall picture of the issuer/guarantor and that NCAs should take a consistent approach in endorsing this principle. It was submitted that maintaining consistency between the URD and the base prospectus would otherwise become too difficult. Additionally, one respondent stressed that updates, in the context of a tripartite or base prospectus, should only occur in accordance with the test set out in Article 23 of the Prospectus Regulation and that draft guideline 6 should not oblige the person responsible for the prospectus to supplement documents at regular intervals as a matter of procedure.

62. There were some further comments regarding the language in the draft guideline which states that 'NCAs should not approve a prospectus'. However, as these comments have already been addressed in this Final Report this issue is not summarised here (see 'General comments to the draft guidelines [...]').

*ESMA's Response:*

63. In terms of the mandate, ESMA's position is that guidelines which assist an NCA in its review are within scope and this guideline has been prepared based on this overarching principle of assistance. ESMA believes that corroboration is inextricably linked to specificity and materiality and the rationale for making such a connection is premised on the text of Article 16(1) which requires that the materiality and specificity of the risk factors is corroborated by the content of the registration document or securities note. Furthermore, it should be acknowledged that corroboration in this context is intrinsically linked with the principle of consistency set out in Article 20 of the PR.

64. ESMA welcomed the majority support for this draft guideline concerning corroboration. ESMA believes that corroboration of specificity and materiality can be achieved by taking into account the overall picture and financial condition of the issuer and has clarified this in the final guidelines. ESMA is prepared to act in case there is a need to provide for further clarifications to NCAs on the application of this guideline if a divergent application is identified.

65. While the matter raised in relation to Member States' differing prospectus liability regimes was brought up on a number of occasions, it bears repeating that NCAs will simply be requesting persons responsible for the prospectus to make disclosure clearer or to request the persons responsible for the prospectus to demonstrate how a risk factor fits within the overall picture of a prospectus. Guidelines are principle based and if there is a clear divergence in practice relating to the application of these guidelines then ESMA will provide further clarifications, if necessary.

66. Lastly, as for URDs and updates in the context of tripartite base prospectuses, Article 23 of the Prospectus Regulation serves as the test for supplements. The final guideline is not intended to force any obligation on persons responsible for the prospectus to have to constantly review these documents. It is expected that NCAs will apply the final guideline by reference to the overall picture of the prospectus. The final guidelines make this clarification.

**Question 6: Do you agree with the suggested draft guidelines on Presentation of risk factors across categories? If not, please provide your reasoning.**

Banking	Investment Services	Legal and Accountancy	Issuers	Regulated Market	Other	Government, Regulatory and Enforcement
7	3	3	7	2	2	1

67. There were 25 responses to question six set out in the Consultation Paper.
68. The draft guidelines on presentation of risk factors across categories proved to be relatively straightforward and did not attract too many significant comments. Broadly speaking these draft guidelines were universally supported, with the exception of two respondents who felt that they were too detailed.
69. There were some comments raised in respect of the explanatory text accompanying draft guideline 7. While most respondents found the lists of categories to be very helpful as examples, a few outlined the importance of the lists being viewed by NCAs as non-exhaustive. Another piece of draft explanatory text which proved to be slightly more troublesome is the text which states that 'a risk factor should only appear once, in the most appropriate category'. Those concerned by the latter highlighted that a risk factor could relate to more than one category and that it might have a different impact depending on the category. One respondent suggested that if this requirement is intended to help shorten risk factor disclosure, it might be helpful to cross-refer to wherever a risk factor is relevant if it could also fit within another category.
70. One point concerning draft guideline 7, which was insisted upon by a small number of respondents, was that while level 1 requires the most material risk factors to be presented first in a given category of risk factors, there is no requirement for further sequential ordering based on materiality. These respondents sought comfort that this will not be misinterpreted by NCAs.
71. A small number of comments were received in relation to draft guideline 10. While some respondents appreciated ESMA's conditional support for the use of sub-categories, i.e. that they can be used in circumstances where their inclusion can be justified, other respondents cautioned against framing the guidelines as a restriction against their use. For those opposed to a restrictive approach, it was submitted that level 1 only sets out a general limitation on the use of categories rather than imposing a restriction on the use of sub-categories.

*ESMA's Response:*

72. The general support for these draft guidelines on presentation across categories was welcome. As far as clarifications are concerned, ESMA's response to the point on the list of examples is that they are non-exhaustive and that they are not indications of categories

that NCAs must see being included in a prospectus, or even that they would be appropriate in all circumstances.

73. As regards the language contained in the explanatory text to draft guideline 7 which states that ‘a risk factor should only appear once, in the most appropriate category’ ESMA agrees that a risk could indeed relate to more than one category. However, while some respondents suggested cross-referencing as a potential solution to overcome the issue of reproducing disclosure and inflating the prospectus, cross-referencing of this nature may be problematic from a comprehensibility perspective. Accordingly, where a risk is relevant in more than one category, ESMA expects persons responsible for the prospectus to use their judgment to ensure that it is presented once, in the most relevant category.
74. With regard to the explanatory text that accompanied draft guideline 7 and the level I requirement for the most material risk factors to be presented first based on their materiality, it appeared that the interpretation of some respondents was that the guideline might go further than level I. For those who sought clarification as to whether additional sequential ordering on the basis of materiality would be required, ESMA confirms that no additional sequential ordering of materiality was envisaged when this draft guideline was produced. NCAs should not apply the final guidelines in a way which goes beyond level I.
75. For those who cautioned against framing the use of sub-categories as a restriction, ESMA has amended both guidelines 9 and 10 so that the option to use sub-categories is no longer limited to only one type of prospectus. The requirement for justifying the inclusion of sub-categories will however remain. Given that the Prospectus Regulation clearly envisages a limitation to the number of categories, it does not appear reasonable to offer scope for sub-categories to be used to undermine this approach.

**Question 7: 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.**

Banking	Investment Services	Legal and Accountancy	Issuers	Regulated Market	Other	Government, Regulatory and Enforcement
7	3	2	7	2	1	2

76. There were 24 responses to question seven set out in the Consultation Paper.
77. The numerical benchmark chosen to represent a limited number of categories was broadly accepted by the market. However, while most respondents were willing to support the draft guideline, their support was subject to NCAs taking a flexible approach when applying it. Two respondents captured the general sentiment which permeated throughout the responses in stating that they agreed with the draft guideline provided that: 1) the intention is simply to build upon the level I requirement of ‘limited’ categories and 2) departures from ten categories may be allowed where there are justifiable grounds. The importance of a

case-by-case assessment was a key point for respondents with great emphasis on NCAs taking a proportionate approach, in particular where a prospectus is more complex.

78. A number of respondents stated that imposing a restriction on the use of sub-categories may lead to situation whereby persons responsible for the prospectus will have to use a greater amount of categories when presenting risk factors and that this could make the limitation set out in the draft guideline more difficult to adhere to. It was further stated that the imposition of an arbitrary limit on the number of categories might result in difficulties for complex prospectuses where the number of risk factor categories may exceed the number of risks factors permitted in summaries.

*ESMA's Response:*

79. ESMA understands that a numerical illustration of what constitutes a reasonable limit on the number categories is an abstract exercise. Consequently, the markets' willingness to support our draft proposed approach was certainly welcome. Having acknowledged the feedback both the final guidelines 9 and 10 have been amended to broaden the use of sub-categories. The use of sub-categories is no longer limited to a particular type of prospectus, as was previously proposed in the draft guidelines.

80. ESMA acknowledges that the support for a numerical benchmark was premised largely on the fact that it built upon the level I principle of 'shall be limited to', but understands that this numerical restriction should not be applied in an inflexible manner. Therefore, ESMA's position is that NCAs should apply the final guidelines on the basis of a case-by-case analysis, meaning that a departure from ten (either more than, or less than) can be permitted.

**Question 8: Do you agree with the suggested draft guidelines on focused/concise risk factors? If not, please provide your reasoning.**

Banking	Investment Services	Legal and Accountancy	Issuers	Regulated Market	Other	Government, Regulatory and Enforcement
7	3	2	7	2	1	2

81. There were 24 responses to question eight set out in the Consultation Paper.

82. The majority of respondents were inclined to support this draft guideline and clearly expressed that the size inflation of prospectuses needs to be addressed. However, while the majority were in favour of tackling the issue of size inflation, there were calls for a balanced approach in achieving this. Many highlighted that this reduction of disclosure must not occur to the detriment of comprehensibility and emphasised the importance of a case-by-case approach. Such an approach was considered necessary in order to take into account factors such as the complexity of a prospectus and circumstances where it may not necessarily be easy for persons responsible for the prospectus to produce concise

disclosure, i.e. in relation to descriptions of other financial services legislation such as banking regulations.

83. Another recurring point concerning the size inflation of prospectuses was that NCAs, according to a small number of respondents, are to some extent contributors to the increasing amount of disclosure. As the draft and final guidelines are addressed to NCAs, those respondents suggested that ESMA should indicate to them that they limit their requests for requiring additional disclosure.
84. Lastly, a small number of respondents questioned whether ESMA had a mandate to produce this draft guideline. Those who raised this point referred to Article 6(2) of the Prospectus Regulation as the provision which sets out the broader concept of presenting information contained in a prospectus in an easily analysable, concise and comprehensible form.

*ESMA's Response:*

85. ESMA welcomed the support for this draft guideline and the general objective of preventing size inflation of prospectuses. However, as pointed out by one respondent, such an exercise may be difficult to accomplish where risk factor disclosure relates to material such as financial services legislation. Accordingly, ESMA is cognisant that any pairing back in volumes of text should simultaneously take into account comprehensibility. As a general response, ESMA wishes to remind stakeholders that the concept of a proportionate approach in the application of these guidelines is an intrinsic feature. It is not expected that NCAs will ignore the importance of case-by-case assessments and matters of common sense, i.e. such as the need to disclose sufficient or extra detail where to do otherwise would completely undermine comprehensibility.
86. As for the questions related to the mandate, ESMA's position is that this guideline assists NCAs in their review, as per Article 16(4) which refers to encouraging appropriate and focused disclosure. While Article 6(2) does indeed set out a general principle of information in prospectuses being presented in an analysable, concise and comprehensible form, the empowerment in relation to risk factors is specific to risk factor disclosure in prospectuses and ESMA is using this empowerment as instructed.

**Question 9: Do you agree with the suggested draft guideline on risk factors in the summary? If not, please provide your reasoning.**

Banking	Investment Services	Legal and Accountancy	Issuers	Regulated Market	Other	Government, Regulatory and Enforcement
7	2	2	7	2	1	1

87. There were 22 responses to question nine set out in the Consultation Paper.

88. The majority of respondents agreed with the draft guideline on risk factors in the summary. For most this draft guideline simply reinforces existing practice and therefore did not prove to be of particular concern. However, while the draft guideline was not contentious, a small number of respondents questioned whether ESMA had the mandate to produce such a guideline. In addition, a few minor clarifications were sought from the market.
89. A small group of respondents requested ESMA to clarify that persons responsible for the prospectus will have discretion as to how they determine and present the most material risk factors. One respondent pointed out that the order of risk factors may change between a base prospectus and an issue specific summary. The change in order in the issue specific summary would be noticeable as a result of some categories being removed for specific issuances, i.e. that they are not relevant. In light of this the respondent expressed hope that NCAs will not be too stringent in the application of the final guideline and will be aware of that fact.
90. Two respondents made a point and raised a question concerning the interactions between draft guideline 12 and the draft guidelines on presentation. One stated that the guidance on sub-categorisation (presumably guideline 10) should not apply in respect of guideline 12. The second respondent queried the interaction between draft guidelines 7 & 12 and requested ESMA to indicate whether it prefers the risk factors in the summary to be presented in order of materiality, or in an order consistent with the risk factor section in the main body of the prospectus.

*ESMA's Response:*

91. In order to address the comments concerning the mandate, ESMA believes that this guideline also falls within the scope of assisting NCAs with their review. ESMA's mandate relates to risk factors as a whole and risk factors are also included in summaries. Given that the summary is an integral part of the prospectus, it is important to have a guideline which allows NCAs to ensure that presentation of risk factors in the summary is consistent with presentation in the main body of the prospectus.
92. As for those respondents who requested ESMA to expressly clarify that persons responsible for the prospectus should have discretion to determine and present the most material risk factors, ESMA highlights that these guidelines do not state anything to the contrary. The guidance simply instructs NCAs to ensure that the order and presentation of risk factors in a summary is consistent with the presentation of risk factors in the main body of the prospectus. In practical terms this imposes no greater burden than ensuring alignment between the order of appearance of risk factors which have been selected for inclusion in the summary and their appearance in the risk factor section. As for the point on sub-categorisation, the general principles that apply to categorisation should apply.

**Question 10: Do you agree with the proposed draft guidelines? Have you any further suggestions with regard to draft guidelines addressing a particular section or the draft guidelines in general?**

Banking	Investment Services	Legal and Accountancy	Issuers	Regulated Market	Other	Government, Regulatory and Enforcement
7	3	2	6	2	1	1

93. There were 22 responses to question ten in the Consultation Paper. Given that many of the responses to question ten are similar to those which were summarised at the outset of this paper (section 4.1) under the heading ‘General comments to the draft guidelines contained in the Consultation Paper’, please refer to the ESMA responses in that part of the paper.

*ESMA’s Response:*

94. Please see section 4.1.

**Question 11: Do you believe that market participants will bear any additional costs as an indirect effect of the suggested draft guidelines? If yes, please indicate the nature of such costs and provide an estimation.**

Banking	Investment Services	Legal and Accountancy	Issuers	Regulated Market	Other	Government, Regulatory and Enforcement
7	3	2	7	2	2	0

95. There were 23 responses to question eleven set out in the Consultation Paper.

96. While some respondents believed that the draft guidelines on risk factors would not be too costly in situations where they adequately reflected the requirements set out in level I, the majority of respondents believed that the introduction of these draft guidelines will bring additional costs.

97. There were a number of reasons given for the projection of additional costs. Certain respondents expect an increase in accountancy/research fees where persons responsible for the prospectus are challenged by NCAs and required to edit risk factors which are based on the financial statements of an issuer. As for legal fees, some believed that added complexity in prospectus reviews will result in an increase to the number of drafts and redrafts of prospectuses. Accordingly, the increase in drafts and redrafts would lead to a corresponding increase in such fees. Those who intend to use universal registration

documents stated that a continuous updating of universal registration documents would be very costly and time-consuming.

98. Another area of concern cited by a few respondents was in respect of issuers who issue debt securities in markets outside of Europe, such as in the United States. Their concerns were that differences between international risk factor disclosure requirements and requirements under the PR will make the achievement of consistency in different offering documents more onerous. According to these respondents any attempt to reconcile disclosure related to risk factors would therefore most likely involve more third party work, i.e. legal, accountancy & tax.

99. Increases in costs were generally cited by respondents to be conditional. Meaning that there was acknowledgement that the new Prospectus Regulation and the new requirements for guidelines on risk factors would expectedly create a more expensive disclosure regime, but that the extent of such an increase will be determined by the flexibility, or any lack thereof, in the application of the final guidelines by NCAs.

*ESMA's Response:*

100. In response to the first point, ESMA believes that these guidelines adequately reflect the requirements set out in level I. While ESMA appreciates the nuanced point concerning adequate reflection of the requirements set out in level I, ESMA would like to emphasise that it has carefully aimed to build on the broad level I concepts by producing guidelines which aim to fall as neatly within the framework of assisting NCAs in their review as possible, and which focus primarily on fundamental aspects of risk factor disclosure. Given the estimated costs associated with the application of these guidelines, ESMA has endeavoured to ensure that the final text of these guidelines and associated explanatory text will make it sufficiently clear that flexibility and proportionality should apply as a matter of logic, in circumstances where this is appropriate.

101. In relation to the feedback concerning costs attached to the disclosure of quantitative information, ESMA notes that the draft guidelines had intended to clarify that quantitative information should be included in risk factor disclosure when this information has already been published and is available to the market. The guidelines do not require that quantitative information is produced solely for the purpose of providing such information in the risk factors disclosures.

102. Article 16 of the Prospectus Regulation set out the future direction for risk factors in EU prospectuses. ESMA was given a clear mandate to work on level III measures with this change of direction in mind. Accordingly, added costs associated with this new steer are not something ESMA can address. However, the final guidelines should hopefully help to cushion the amount of costs associated with the new obligatory requirements by providing as much flexibility as possible.

103. ESMA is not creating any additional obligations via the development of these final guidelines. ESMA is simply attempting to clarify the provisions in level 1 in order to assist NCAs in their review process. The introduction of the final guidelines could also be read

as providing an overall benefit in terms of increased clarity on the functioning of the regulatory framework.

## Annex I: List of respondents

	<b>Banking</b>
1	Association for Financial Markets in Europe (AFME)
2	European Savings and Retail Banking Group
3	Finance Denmark
4	French Banking Federation
5	German Banking Industry Committee
6	Italian Banking Association
7	Swedish Bankers' Association
	<b>Government, Regulatory and Enforcement</b>
8	CNMV Advisory committee
	<b>Investment Services</b>
9	AMAFI
10	Eumedion
11	Swedish Securities Dealers Association
	<b>Issuers</b>
12	AFEP
13	Deutsches Aktieninstitut
14	European Issuers
15	German Derivatives Association (DDV)
16	Quoted Companies Alliance
17	Confidential
18	Confidential
	<b>Legal and Accountancy</b>
19	Accountancy Europe

20	De Brauw Blackstone Westbroek
21	Law Society of England and Wales
	<b>Others</b>
22	International Capital Market Association (ICMA)
23	Iñaki Viggers
	<b>Regulated markets, exchanges and trading systems</b>
24	Euronext
25	FESE

## Annex II: The guidelines on risk factors

### I. Scope

#### Who?

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

#### What?

2. These guidelines are to assist competent authorities when 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 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.

#### When?

3. These guidelines apply from [insert the date of their publication on ESMA's website in all official languages of the EU].

## II. Legislative references, abbreviations and definitions

### Legislative References

<i>Prospectus Regulation (PR)</i>	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.
<i>Market Abuse Regulation</i>	Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC.
<i>ESMA Regulation</i>	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.

## Abbreviations

<i>ESMA</i>	European Securities and Markets Authority
<i>RD</i>	Registration Document

## Definitions

<i>Persons responsible for the prospectus</i>	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
<i>SN</i>	Securities Note

## 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 can assess the relevant risks related to their investment and can therefore make informed 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/or its securities and which are corroborated by the content of the prospectus.
5. These guidelines are based on Article 16 (4) of the Prospectus Regulation. The guidelines aim to encourage appropriate, focused and more streamlined disclosure of risk factors, in an easily analysable, concise and comprehensible form, by assisting competent authorities in their review of the specificity and materiality and of the presentation of risk factors across categories. These guidelines are not limited to the risk factors of any particular type of entity or any particular type of prospectus.
6. Although these guidelines are addressed to competent authorities pursuant to Article 16 (4) of the Prospectus Regulation, in order to expedite the process of approving prospectuses, RDs, URDs, SNs and any supplements thereto, persons responsible for the prospectus should consider these guidelines when preparing a prospectus for submission to the relevant competent authority.

## **IV. Compliance and reporting obligations**

7. These guidelines are addressed to competent authorities. In accordance with Article 16(3) of the ESMA Regulation, competent authorities shall make every effort to comply with these guidelines.
8. Competent authorities to which these 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 these guidelines on ESMA's website in all EU official languages, competent authorities to which these 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 guidelines.
10. In case of non-compliance, competent authorities must notify ESMA within two months of the date of publication of the guidelines on ESMA's website in all EU official languages of their reasons for not complying with the 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 guidelines are set out in bold and are followed by explanatory paragraphs. Competent authorities should comply with the guidelines and should consult the subsequent explanatory paragraphs to facilitate their review of risk factors.
13. When reviewing risk factors, competent authorities should note that the criteria of specificity, materiality and corroboration are cumulative, as illustrated in Article 16(1) of the Prospectus Regulation. Therefore, when reviewing the disclosure of risk factors, competent authorities should consider whether risk factors are specific, material and corroborated as set out in Article 16(1) of the Prospectus Regulation. It should be clear in the disclosure that all criteria have been fulfilled where a risk factor is included in a prospectus.
14. When challenging the persons responsible for the prospectus in relation to the disclosure of risk factors, the competent authority should provide the persons responsible for the prospectus with the opportunity to respond or to amend the disclosure, as appropriate. This phase of the review process should be a discussion between the competent authority and the persons responsible for the prospectus. If the persons responsible for the prospectus are unable or unwilling to make the necessary changes or to provide supplementary information, the competent authority should use the powers pursuant Article 20 of the Prospectus Regulation in order to

ensure that the persons responsible for the prospectus comply with Article 16 of Prospectus Regulation.

15. In addition, when challenging the comprehensibility of risk factor disclosure pursuant to these guidelines, competent authorities may take into account the type of investor to whom the prospectus is addressed (i.e. whether the securities have a denomination per unit of at least €100,000, or the securities are to be traded only on a regulated market, or a specific segment thereof, to which only qualified investors can have access for the purposes of trading in such securities).

## VI. Guidelines on risk factors

### VI.1. Guidelines on Specificity

**Guideline 1: Before approving the prospectus, the competent authority should ensure that specificity of the risk factor is clear from the disclosure. In this regard:**

- i. **The competent authority should challenge the persons responsible for the prospectus where the disclosure of a risk factor does not establish a clear and direct link between the risk factor and the issuer, guarantor or securities or if it appears that risk factor disclosure has not been drafted specifically for the issuer/guarantor or the securities; and**
  - ii. **Where necessary, the competent authority should request that the persons responsible for the prospectus amend such risk factor or request a clearer explanation.**
16. 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.
17. Each risk factor should identify and disclose a risk that is relevant to the issuer/guarantor or the securities concerned rather than simply comprising of generic disclosure.
18. Issuers operating within the same industry may be exposed to similar risks and therefore disclosure related to these types of issuers can indeed be similar. However, industry/sector specific risks may affect issuers differently depending, for instance, on their size or market shares, and therefore, it is expected that, where relevant, these differences are also reflected in the disclosure of a given risk factor.
19. The same logic as outlined above applies to disclosure concerning similar types of securities.
20. During the review, the competent authority should also consider the interdependencies that risk factors may have, e.g. that the risk associated with a security may be higher or lower depending on the financial condition of the issuer or

the credit quality of a pool of assets underlying a series of notes. Therefore, the disclosure of risk factors should reflect this.

21. Competent authorities are not required to assess the specificity of a risk factor, the specificity assessment remains the responsibility of the issuer who should ensure that the disclosure of the risk factor clearly demonstrates that the risk is specific. However, the competent authority should ensure that the specificity of the risk factor is apparent from the disclosure of the risk factor

**Guideline 2: The competent authority should challenge the inclusion of risk factors that only serve as disclaimers. Where necessary, the competent authority should request that the persons responsible for the prospectus amend such risk factor or request a clearer explanation.**

21. Risk factors should not only serve the purpose of shielding persons responsible for the prospectus from liability. Risk factor disclosure that serves only as a disclaimer is not typically issuer, guarantor or security specific.
22. Disclaimers often obscure the specificity and materiality of a risk factor and/or other risks that the issuer/guarantor is exposed to, as they often only contain generic language and do not provide clear descriptions of the specificity of the risks.
23. 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.

## **VI.2. Guidelines on Materiality**

**Guideline 3: Before approving the prospectus, the competent authority should ensure that materiality of the risk factor is clear from the disclosure. In this regard:**

- i. **Where materiality is not apparent from the disclosure in the risk factor, the competent authority should challenge the inclusion of the risk factor; and**
  - ii. **Where necessary, the competent authority should request that the persons responsible for the prospectus amend such a risk factor or request a clearer explanation.**
24. 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 16 (1) of the Prospectus Regulation.
25. Competent authorities are not required to assess the materiality of a risk factor, the materiality assessment of risks remain the responsibility of the issuer who should

ensure that the disclosure of the risk factor clearly demonstrates that the risk is material. However, the competent authority should ensure that the materiality of the risk factor is apparent from the disclosure of the risk factor.

**Guideline 4: The competent authority should challenge the persons responsible for the prospectus where the potential negative impact of the risk factor on the issuer/guarantor and/or the securities is not disclosed and request appropriate amendments.**

26. ESMA believes that providing quantitative information within the disclosure of risk factors helps to demonstrate the materiality of a specific risk factor. Such information may be available in previously published documents such as management reports, financial statements or ad-hoc-disclosures pursuant to Article 17 of the Market Abuse Regulation.
27. Alternatively, where quantitative information is not available or where it is not appropriate to include such information in the prospectus, the description of the potential negative impact of the risk factors should be described using a qualitative approach. For this purpose, 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 the penultimate paragraph of Article 16(1) 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. Nonetheless, where a qualitative approach is undertaken, the impact of the risks should be adequately explained and be consistent with the order of the most material risk factors within each category pursuant to Article 16(1) of the Prospectus Regulation and as also referred to in paragraph 33 of these guidelines.
28. Nevertheless, if qualitative information is included to describe the potential negative impact of a risk factor, the competent authority should ensure that the materiality of the risk factor is evident from its disclosure.

**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 request that the persons responsible for the prospectus amend the risk factor disclosure, in order to remove such mitigating language.**

29. Mitigating language is not prohibited. Where mitigating language is included in relation to a risk factor, it can only be used to illustrate probability of occurrence or expected magnitude of negative impact. Excessive or inappropriate use of mitigating should be avoided. Such mitigating language could limit a reader's perception of the true extent of a risk factor's negative impact or of its probability of occurrence, to the point that the reader is no longer clear whether there is any remaining material risk. Mitigating language should therefore not be used in this manner.
30. An example of excessive mitigating language may be lengthy and detailed descriptions of risk management policies. Where risk management policies are in

place, the persons responsible for the prospectus should (re)assess the materiality of the risk taking the risk management policies into account, before including a risk factor in a prospectus. Furthermore, if a risk described in the risk factors section of a prospectus is material despite an issuer's risk management policies, then this should be clear in the disclosure of the risk factor. Where the disclosure of the policies in place mitigate the risk to the extent that it is no longer material, the risk or the mitigating language should be removed.

### **VI.3. Guidelines on Corroboration of the materiality and specificity**

**Guideline 6: Before approving the prospectus, the competent authority should ensure that the materiality and specificity of the risk factor is corroborated by the overall picture presented by the prospectus. In this regard:**

- i. 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 a risk factor; and**
  - ii. 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.**
31. While direct/clear corroboration of the materiality and specificity of the risk factor is normally demonstrated via the inclusion of specific corresponding information elsewhere in a prospectus, this is not necessary in all circumstances. In certain 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. 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. Before approving the prospectus, the competent authority should ensure that risks factors are presented across categories based on their nature. In this regard:**

- i. Where this is not the case, the competent authority should challenge the presentation; and**
  - ii. Where necessary, the competent authority should request that the persons responsible for the prospectus amend the presentation of risk factors across categories.**
32. 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 only appear once, in the most appropriate category.

33. In accordance with Article 16 of the Prospectus Regulation, the most material risk factors have to be presented first in each category, but it is not mandatory for all the remaining risk factors within each category to be ranked in order of their materiality.
34. Risk factors which are specific and material to the issuer/guarantor could, for example, be divided into the following categories:
- Risks related to the issuer's financial situation;
  - Risks related to the issuer's business activities and industry;
  - Legal and regulatory risk;
  - Internal control risk; and
  - Environmental, social and governance risks.
35. Risk factors which are specific and material to the securities could, for example, be divided into the following categories:
- Risks related to the nature of the securities;
  - Risks related to the underlying;
  - Risks related to the guarantor and the guarantee; and
  - 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 challenge the persons responsible for the prospectus and request amendments when categories are not identified within the risk factors section of the prospectus via the use of appropriate headings.**

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

**Guideline 9: The competent authority should challenge the persons responsible for the prospectus and request amendments to the number of categories and sub-categories included in the prospectus where they are disproportionate to the size/complexity of the transaction and risk to the issuer/guarantor.**

38. Competent authorities should challenge the presentation of risk factors across categories when the persons responsible for the prospectus includes more than ten categories and sub-categories in the case of a standard, single-issuer, single-security prospectus. In other circumstances, the figure can be extended depending on the case. ESMA understands multi-product base prospectuses to be an example where further categories/sub-categories may be appropriate.

39. However, the competent authority may still challenge the figure of up to ten categories and sub-categories, if fewer categories and sub-categories are sufficient to present risk factors in a comprehensible manner.

**Guideline 10: When assessing the presentation of risk factors, categories should only be further divided into sub-categories in cases where sub-categorisation can be justified on the basis of the particular prospectus. Where there is no clear or obvious necessity for the use of sub-categories the competent authority should challenge the persons responsible for the prospectus and request amendments to the presentation in the risk factors section where comprehensibility is compromised.**

40. Sub-categories should only be used where their inclusion can be justified based on the particular circumstances of the case. 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.
41. 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. Guidelines on Focused/concise risk factors**

**Guideline 11: Before approving the prospectus, the competent authority should ensure that the disclosure of each risk factor is presented in a concise form. In this regard:**

- i. Where this principle is not complied with, the competent authority should challenge the presentation; and**
  - ii. Where necessary, the competent authority should request the persons responsible for the prospectus to provide more focused and concise disclosure.**
42. 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, may obscure the comprehensibility of a prospectus. Therefore, the competent authority should challenge the length of the risk factors disclosure to ensure that the materiality and specificity of the risk factor is clear and its presentation is appropriate and focussed.

## **VI.6. Guidelines on Risk factors in the summary**

**Guideline 12: Where a summary has been included in the prospectus, before approving the prospectus the competent authority should ensure consistency in disclosure presentation. In this regard:**

- i. Where this principle is not complied with, the competent authority should challenge the persons responsible for the prospectus; and**
  - ii. Where necessary, the competent authority should request amendments where the disclosure of risk factors in the summary is not consistent with the order of the risk factors section in a prospectus.**
43. When reviewing risk factors in the summary, the competent authority should check if their presentation is consistent with their presentation based on materiality in the risk factor section. This, however, does not mean that the summary must include risk factors from all of the categories included in a prospectus.

## Appendix I: Examples of specific and material risk factors:

The examples set out in Appendix I are for illustrative purposes only.

Competent authorities may consider Appendix I when carrying out their review of the disclosure contained in risk factors. The appendix contains **non-exhaustive examples** which aim to illustrate 1) how the specificity of a risk factor can be demonstrated 2) how both the specificity and materiality of a risk factor can be demonstrated together and 3) an example of mitigating language.

### **Examples:**

As set stated in Section V entitled 'Background' (at the outset of this paper containing the guidelines) risk factor disclosure should demonstrate both specificity and materiality.

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.

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.

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:

**Mitigating language:**

The following is an illustration of mitigating language which 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:

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.