

**FESE Response to the ESMA Consultation Paper  
'Guidelines on risk factors under the Prospectus Regulation'**

**Introduction**

FESE Members welcome the opportunity to respond to ESMA's Consultation Paper on the guidelines on risk factors under the new Prospectus Regulation.

We support the work that ESMA is doing to provide clarification on Level 2. We believe that clear instructions will facilitate both issuers and investors. As indicated in our response, in particular in line with the responses to Q1 and Q5, we would like to ask ESMA for more guidance on how these guidelines will apply in practice and whether they might result in a barrier to entry.

**Specificity**

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

FESE members support the principle that risk factors should be drafted with specificity to the issuer, guarantor or securities.

We also support ESMA's peer review findings that the inclusion of generic risk factors leads to lengthy, cumbersome risk factor sections that have no benefit to investors.

As highlighted, FESE would request further clarification regarding the following points in addition to the examples already provided by ESMA:

- Risk factors often address geopolitical events, economic environment, recent legislative changes etc. Will NCAs continue to allow these types of risks to be construed as specific to the issuer, guarantor or securities?
- The draft guidelines state that the competent authority should not approve a prospectus where specificity is not apparent from the disclosure of the risk factor. Is the scope of the NCA's review therefore limited to check whether disclosure exists (which would explain why the issuer considers the risk factor specific) or can NCAs disagree with an issuer's assessment of a risk factor as specific?
- If there is disagreement between the NCA and persons responsible for the prospectus as to whether a risk factor is adequately specific for inclusion, how is an agreement reached?
- Can exclusion of risk factors that the NCA considers non-specific to the issuer, guarantor or securities expose the persons responsible to liability (as outlined in Guidelines 1 & 2) and will this therefore pose as a barrier to prospectus approval across the EU?
- If the view of the NCA prevails and risk factors are removed, could this expose NCAs to liability?

**Materiality**

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

We understand that, although a definition of 'materiality' is not included in the Prospectus Regulation, ESMA is referring to the definition included in the IFRS conceptual framework, i.e. information is material if omission or misstatement could negatively influence investment decisions based on use of the prospectus.

In the absence of an express definition in the Prospectus Regulation, we consider it a good idea to include this extrapolated concept of "materiality" in the guidelines in order to allow a consistent application of materiality across all prospectus approval applications in the EU.

However, we would query the scope of competent authorities' review under Guideline 3.

The current wording states that NCAs should challenge where 'materiality' is not apparent. ESMA should clarify whether this simply means that NCAs have to ensure that the responsible persons have provided a rationale as to why they consider a particular risk material or whether NCAs can disagree as to whether a risk is material or not. In the case of the latter, clarification is necessary as it could lead to exposure to liability of either the responsible persons or the NCA and would lead to the same concerns raised under our response to Q1.

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

Based on ESMA's explanatory text, we understand Guideline 4 as follows: quantitative information should be provided where available but, in its absence, qualitative disclosure may be provided. Qualitative disclosure may be presented by reference to a scale of low, minimum or high (although responsible persons are not obliged to provide such scaled ranking of risks). In the absence of any guidance as to how low, medium or high can be defined, we would query whether this will lead to inconsistency of scaled risk by both responsible persons and NCAs, which ultimately will be of no benefit to investors. In order to ensure a level playing field across the EU, we would ask ESMA to either provide further guidance as to scaling or alternatively, to provide examples of low, medium and high risks.

We would also query the scope of competent authorities' review under Guideline 4. Can a competent authority disagree with an issuer's assessment as to how negative the impact is or how material the risk is? For example, if an issuer uses a scale of low, medium or high to rank a risk, can a competent authority disagree with the ranking of a risk as low if it feels the risk should be medium or high? FESE Members feel these are important points for ESMA to clarify so that responsible persons understand who has the final say in materiality of a risk. If the final say lies with the NCA, this may have a deterrent effect on prospectus approval across the EU.

Finally, we note that ESMA acknowledges that other pieces of European legislation require issuers to provide quantitative disclosure regarding financial risks. ESMA points out that risk factors should be concise, focused and appropriate for investors targeted by the prospectus and thus, reproduction in full of such disclosure in a prospectus would be inappropriate. ESMA's explanatory text suggests that this other disclosure "could be tailored for the purpose of including it in the prospectus." This would appear to preclude incorporating other such disclosure by reference by the absence of a cross-referencing table. Therefore, the remaining alternative is for issuers to reproduce shortened versions of disclosure acceptable under other EU legislation in order for it to satisfy ESMA's guidelines for prospectus inclusion. We would consider that either approach will lead to duplication of effort and increased costs for issuers. FESE Members would also consider that disclosure which satisfies other pieces of EU legislation should be considered appropriate under the Prospectus Regulations.

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

FESE acknowledges ESMA's concern that mitigating language could limit the perception of risk to the extent that the reader is unclear as to whether any risk remains. ESMA considers that mitigating language cannot be used to undermine the principle of "risk" attached to relevant securities.

Whilst we appreciate ESMA's concerns, we would consider 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. According to the explanatory text for guideline 5, the competent

authority can require removal of mitigating language “if the competent authority believes that mitigating language included in the prospectus renders the relevant risk factor immaterial.” Whilst ESMA does not proscribe mitigating language such as risk management practices/policies, it will only allow its inclusion to the extent that it does not negate the risk and where the remaining material risk is made clear. ESMA should consider whether this guideline will deter issuers from seeking approval in the EU if they feel that an NCA can prevent them from, in their view, adequately mitigating risk.

From a practical standpoint, we note that ESMA considers that it may be relevant for the prospectus to refer to risk management practices but that lengthy descriptions of same should not be included in the risk factor section. We would note, however, that Article 7(11) of the Prospectus Regulation does not permit cross-references in the summary; accordingly, risk factors presented in the summary may therefore be required to include mitigating risk management practices/policies etc. as cross-referencing is not allowed. We would welcome guidance on this point.

### **Corroboration**

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

FESE agrees in general that risk factors should be capable of being supported by corroborating information but have concerns as to application. To that end, we would ask ESMA to provide further guidance as to how corroboration requirements will be applied by competent authorities to ensure a consistent approach that does not result in a barrier to entry.

From a practical standpoint, we would also welcome clarification as to the following language taken from the guideline: “Where the competent authority considers that the materiality and specificity of a risk factor is not corroborated by a reading of the prospectus, the competent authority should challenge the inclusion of such risk factor.” Does this highlighted language allow the corroboration requirement to be satisfied within the risk factor (by including detail which adequately explains the risk) or must there be further corroboration elsewhere in the prospectus? We would consider the former to be more favourable from both a cost and replication standpoint.

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

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

FESE Members agree that risk factors should be presented in a way that supports comprehensibility and assists investors in understanding the nature and source of each.

We generally agree that a risk factor should appear only once, in the most appropriate category but would ask ESMA to consider exercising flexibility if an issuer can demonstrate that a particular risk factor falls across more than one category as we believe this is a determination that issuers are best placed to make.

**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.*

FESE agrees on the basis of ESMA’s confirmation that (i) the intention of the guideline is to build on the Level 1 requirement of “limited” categories while still allowing for flexibility; and (ii) departures from ten categories may be allowed where there are justifiable grounds. Once again, we would consider that the issuer is best placed to determine whether more than ten categories are justified in a particular prospectus so it is of utmost importance that flexibility is allowed in this regard.

### **Focused/concise risk factors**

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

We agree that NCAs should challenge wording and request more focused disclosure where risk factors are not presented in a concise form. This appears to be a practical way to address the “size inflation” issue referred to by ESMA in its explanatory text and will ensure investors will not have to wade through content obscuring the perception of risk.

### **Summary**

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

We agree that the presentation of risk factors in the summary should be consistent with the order of risk factors in the risk factor section.

### **General**

**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 guidelines in general?*

We agree in general with the proposed draft guidelines but would welcome further clarification as set out in Questions 1 through 5.

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

In our opinion, issuers are likely to incur additional costs adjusting to the new, more prescriptive regime for risk factor disclosure because issuers and their legal advisors will need to consider how best to meet their obligations, with a specific focus on specificity, materiality, corroboration, categorisation and conciseness.