



European Securities and  
Markets Authority

# Guidelines

**On Risk factors under the Prospectus Regulation**



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## **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 04/12/2019.

## II. Legislative references, abbreviations and definitions

### Legislative references

<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 <sup>1</sup>
<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 <sup>2</sup>
<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 <sup>3</sup>

### 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
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<sup>1</sup> OJ L 331, 15.12.2010, p. 84.

<sup>2</sup> OJ L 173, 12.06.2014, p. 1.

<sup>3</sup> OJ L 168, 30.06.2017, p.12.



<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**

### **Status of the guidelines**

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 also 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.**

22. 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.
23. 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.
24. 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.**
25. 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.
26. 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.**

27. 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.

28. 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.
29. 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.**

30. 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.
31. 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.**
32. 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.**
33. 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.
34. 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.
35. 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

36. 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.**

37. 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.

38. 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.**

39. 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.

40. 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.**

41. 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.

42. 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.**
43. 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 focused.

#### **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.**
44. 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.