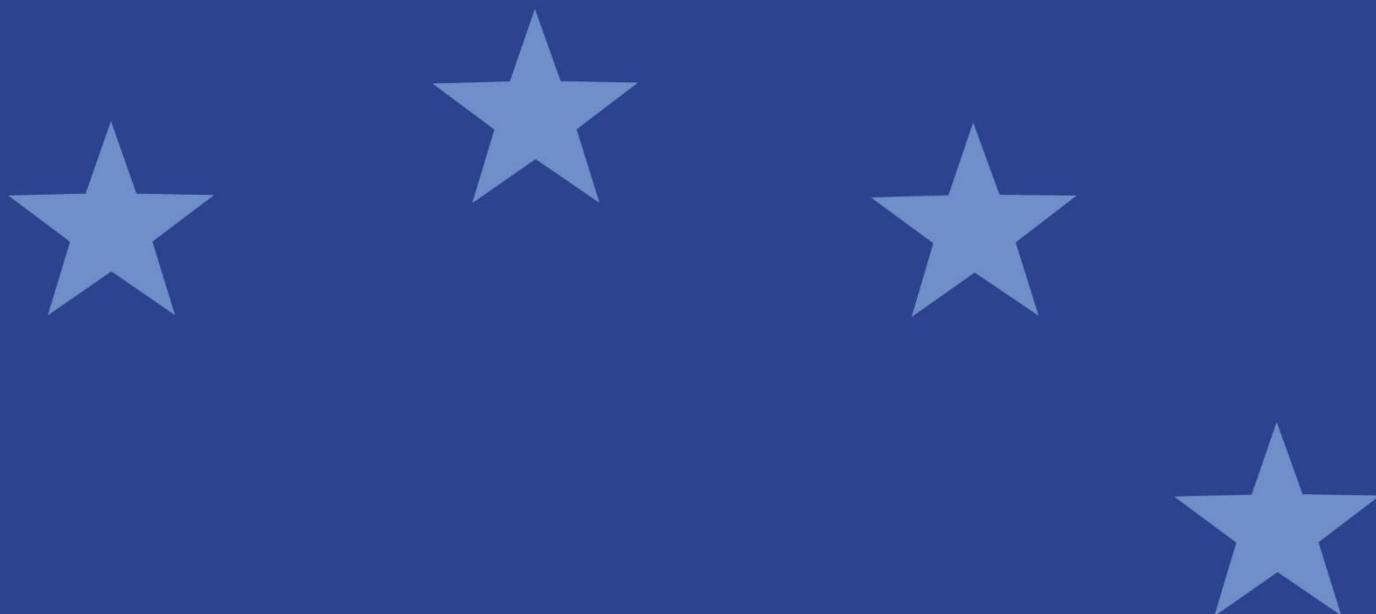


Consultation Paper

Guidelines on risk factors under the Prospectus Regulation





Responding to this paper

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

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

ESMA will consider all comments received by **05 October 2018**.

Instructions

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

- Insert your responses to the questions in the Consultation Paper in the present response form.
- Please do not remove tags of the type <ESMA_QUESTION_GRF_1>. Your response to each question has to be framed by the two tags corresponding to the question.
- If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.
- When you have drafted your response, name your response form according to the following convention: ESMA_GRF_nameofrespondent_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA_GRF_ABCD_RESPONSEFORM.
- Upload the form containing your responses, **in Word format**, to ESMA’s website (www.esma.europa.eu under the heading ‘Your input – Open consultations’ → “Consultation on Guidelines on risk factors under the Prospectus Regulation”).

Publication of responses

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



Data protection

Information on data protection can be found at <https://www.esma.europa.eu/data-protection>.

Who should read this paper

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



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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
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

1. Executive summary

Reasons for publication

Regulation (EU) 2017/1129 was published in the Official Journal of the European Union on 30 June 2017 and partially entered into force on 20 July 2017. In accordance with Article 16(4) of the Prospectus Regulation an empowerment is addressed to ESMA to develop guidelines to assist competent authorities in their review of risk factors.

According to Article 16(2) of Regulation (EU) No 1095/2010, ESMA shall, where appropriate, conduct open public consultations regarding guidelines and analyse the related costs and benefits. These draft guidelines should be incorporated by competent authorities, as part of their review practices, when scrutinising and approving a prospectus drawn up in accordance with the Prospectus Regulation, following the full implementation of the Prospectus Regulation in July 2019. Although these draft guidelines are not directly addressed to financial market participants, ESMA considers it necessary to publicly consult on their content considering that financial market participants should take them into account when drawing up a prospectus.

Contents

This Consultation Paper is being published to invite comments in relation to the proposed draft guidelines on risk factors, which have been prepared to assist competent authorities in their review of risk factors.

Section 2 provides information on the mandate for preparing these draft guidelines and some general explanatory material. Section 3 clearly sets out the objectives and aims of these draft guidelines.

Section 4 describes how competent authorities should comply with the draft guidelines. Section 5 provides information on how to read this Consultation Paper and to consider its contents.

Section 6 contains the proposed guidelines and their accompanying explanatory text. In addition, some additional information is contained in this section for the purpose of the Consultation Paper only and the purpose of such information is generally to outline the rationale for any proposals.

ESMA has included a number of questions throughout the Consultation Paper and to invite stakeholder feedback. For convenience, the questions are summarised in Annex I.

Next Steps

ESMA will consider the feedback it receives to this Consultation Paper by Q3 2018. A Final Report containing a summary of all consultation responses and a final version of the guidelines is expected to be published on ESMA's website in Q1 of 2019.

2. Introduction

2.1. Mandate

1. 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 ('the Prospectus Regulation') was published in the Official Journal of the European Union on 30 June 2017.
2. Under Article 16(4) of the Prospectus Regulation 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 considerations

3. ESMA was set up with the objective of helping foster investor protection and to contribute to the establishment of high-quality common regulatory and supervisory standards and practices. ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. One of ESMA's areas of responsibility is to promote the effective and consistent application of European financial services legislation with the overall objective of ensuring that investors are provided with consistent and good disclosure that enables them to make informed investment decisions.
4. The 2016 peer review on the prospectus approval process (ref. ESMA/2016/1055) identified risk factors as an area in need of further guidance, particularly due to the tendency of issuers to present very lengthy and non-specific risk factors along with information mitigating the risk factors to an extent that they are negated. In this regard draft guidelines have been proposed to address each of the aforementioned issues.
5. ESMA acknowledges the importance of risk factors, in order to assist investors in making informed investment decisions. Such information allows investors to gain a better understanding of factors to be considered when evaluating whether or not to purchase securities issued by a specific entity. The inclusion of appropriate, concise and focused risk factor disclosure can be facilitated through robust and harmonised supervisory review. In order to facilitate European financial regulators with their review of risk factors contained in a prospectus, ESMA intends to issue these draft guidelines, which should serve as a supervisory tool to encourage consistent and relevant disclosure for the purpose of investor protection.
6. The draft guidelines expand on the concepts and instructions provided for in Article 16 of the Prospectus Regulation, namely: specificity, materiality, corroboration and categorisation of risk factors. In addition these draft guidelines are also accompanied by explanatory text providing competent authorities with the necessary information

required to comply with the principles outlined in the draft guidelines. In this respect, ESMA notes that persons responsible for the prospectus must ensure that risks factors included in a prospectus fulfil the criteria set out in the Prospectus Regulation.

7. ESMA believes that in order to expedite the scrutiny and approval process in accordance with Article 20 of the Prospectus Regulation, persons responsible for the prospectus should consider these draft guidelines when carrying out their own assessment of risk factors to be included.
8. Finally, it is important to note that Article 16 (5) of the Prospectus Regulation contains a further empowerment providing the EU Commission with the option to draft Level 2 measures which could be addressed to both competent authorities and persons responsible for the prospectus.

3. Purpose and Scope

9. As stated in Recital 54 of the Prospectus Regulation, the primary purpose of including risk factors in a prospectus is to ensure that investors make an informed assessment of such risks and thus take investment decisions in full knowledge of the facts. Risk factors should therefore be limited to those risks which are material and specific to the issuer (and/or the guarantor, if applicable) and its securities and which are corroborated by the content of the prospectus.
10. The draft guidelines aim to encourage appropriate, focused and more streamlined disclosure of risk factors, in an easily analysable, concise and comprehensible form. These draft guidelines are general in nature and not limited to the risk factors of any particular type of entity or any particular type of prospectus.
11. As envisaged by Article 16 (4) of the Prospectus Regulation, these draft guidelines are intended to achieve this purpose by assisting NCAs in their review of the specificity and materiality of risk factors and of the presentation of risk factors across categories depending on their nature.

4. Compliance and reporting obligations

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

5. Background

14. When reading the text contained in the Consultation Paper, please note that the language presented in **bold** and **italics** is taken from the draft guidelines with which competent authorities should comply. Any text that follows the draft guidelines which is also presented in **italics**, but not in bold, constitutes explanatory, elaborating and exemplifying text for the purpose of assisting competent authorities during their review. An annex has been attached to this Consultation Paper which contains the draft guidelines and explanatory text to the draft guidelines only.
15. Any text included in this Consultation Paper, which is preceded by italicised text, has been included to provide background information and rationale for the relevant guideline
16. Although the draft guidelines presented in bold and italics (and included in the annex to this paper) are addressed to competent authorities, ESMA draws the attention of all readers of this Consultation Paper to the fact that, persons responsible for the prospectus, must ensure that risks factors in a prospectus fulfil the criteria set out in Article 16 of the Prospectus Regulation. ESMA expects that persons responsible for the prospectus will take the draft guidelines into account before submitting a draft prospectus, RD, URD and any supplements thereto, to a competent authority for approval. ESMA invites investors and all interested parties to provide their input in relation to these draft guidelines, in order to improve the quality of disclosure in relation to risk factors.
17. Finally, ESMA further emphasises the fact that the concepts of specificity, materiality and corroboration are linked, as illustrated in Article 16(1) of the Prospectus Regulation. Therefore, risk factors included in a prospectus, RD, URD, should be both specific and material and it should be clear from the description of a risk factor that both criteria have been fulfilled where a risk factor is included in a prospectus.

6. The draft guidelines

6.1. Specificity

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

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.

Each risk factor should identify and describe a risk that is relevant for the issuer/guarantor or the securities concerned rather than simply disclosing 'boiler-plate' risks, or using 'boiler-plate' disclosures.

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.

18. The findings of the ESMA Peer review on Prospectus approval process concluded that the inclusion of generic risk factors leads to the production of lengthy and cumbersome risk factor sections, which do not serve investors from the perspective of pinpointing the most relevant details concerning risk related to the issuer/guarantor or the securities. In addition, the practice of including generic risk factors undermines the notion of specificity and therefore competent authorities should challenge the inclusion of such in order to achieve the aim of providing more appropriate and focused disclosure.
19. In addition, the practice of recycling 'boiler-plate' risk factors, from previous or other prospectuses, has been well-documented by competent authorities. In order to achieve the goals envisaged by Recital 54 and Article 16 of the Prospectus Regulation, it would appear necessary to prevent the continuance of this practice where not relevant. Accordingly, this guideline has been drafted to provide competent authorities with a tool which offers scope to require that the risk factors contained in the prospectus have been included following a researched assessment of their specificity, rather than on the basis of an extraction and transfer of disclaimers from other documents.

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

20. Competent authorities should note that it is not expected for persons responsible for the prospectus to include a description of every single risk that is specific to the issuer/guarantor, or the securities offered/to be admitted to trading on a regulated market. If persons responsible were to include the entire range of risks that are specific to the issuer the material risks could be obscured. Therefore, a risk that is entity and security-specific should be depicted in the prospectus risk factors section only if it is material for an investment decision.

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

- 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.

21. When considering both of the above, example one demonstrates a specific risk to this particular issuer's production and supply chain. The materiality of this specific risk is evident from the fact that such an overflow could affect the main production site of the issuer. In example one, the frequency of occurrence of this specific risk (almost every spring) further demonstrates the probability of occurrence. Example two, which assumes the issuer continues to have exposure to this risk, demonstrates specificity by virtue of highlighting how the loss of the ISO certification is of major significance to the issuer in determining its business as a supplier. The frequent periodic assessments demonstrate specificity from the perspective that this evaluation constitutes a routine risk to which this issuer is specifically subject. The materiality of this specific risk is clear from the perspective that the issuer could lose its contract, as a supplier, for its

¹ Please note that although materiality is addressed in section 6.2 of this CP, for the purpose of the examples presented in this section on specificity, both the principles of specificity and materiality have been considered.

two largest customers. Failure on the part of the issuer to adhere to these rigorous sustainability criteria and compliance assessments presents a quantifiable loss which can be illustrated numerically i.e. 40% of last year operating profits (expected magnitude of the negative impact).

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

1) *The degree of liquidity of such securities:*

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

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

The subordinated notes constitute unsecured debt claims over Bank ABC.

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

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

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

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

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

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

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

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

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

22. When considering all of the above, example one sets out a specific risk related to the liquidity of the securities which may have a material impact on the price at which an investor can dispose of the securities at short notice. The restrictions on the free float of shares and the potential lack of liquidity which could foreseeably arise is a factor which investors may wish to consider before purchasing the shares.
23. As regards example two, the materiality of the bail-in disclosure for subordinated debt securities is evident from the fact that the Bank's exposure to the non-performing loans held on its balance sheet leaves potential unsecured noteholders in a precarious position, in the event the defaults increase above a quantifiable percentage. The net effect of such an increase in defaults might constitute such a threat to the financial position of this Bank, that it might force the engagement of the bail-in mechanism of winding-down and selling off the Bank's assets. Due to the noteholders' position in the capital structure of the Bank, there is a risk they may not be paid any monies out of the wind-down sale or may risk becoming owners in the equity of the Bank.

24. Example three is a clear illustration of specificity and specific risks related to bonds issued in a currency other than the domestic currency of the investor – which in this example is assumed to be the euro. The risk factor illustrates how changes in exchange rates might dictate the euro value of an instrument held by any investor who wishes to purchase or subscribe for non-euro denominated bonds. The materiality is illustrated by the periodic variations and frequency of scope for rate mismatches between a currency pair along with further potential compounding factors. In addition, the materiality is illustrated by the fact that there is a level of uncertainty regarding the extent of any mismatches in value and the potential loss which may occur on any capital invested.

QUESTIONS FOR CONSULTATION

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

6.2. Materiality

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

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. Article 16(1) of the Prospectus Regulation requires the risk factors featured in the prospectus to be limited to those which are '[...] material for taking an informed investment decision'. Secondly, the aforementioned provision speaks to materiality of risk factors based on '[...] the probability of their occurrence and the expected magnitude of their negative impact'.
26. Where a risk factor does not appear to fall within the scope of the criteria determining materiality set out in Article 16 of the Prospectus Regulation, competent authorities should challenge the inclusion of the risk factor in the prospectus, RD, URD or any supplement or should request a clearer explanation of the materiality.
27. Although the Prospectus Regulation or these draft guidelines do not define materiality, the IFRS conceptual framework has defined materiality as:

“Information is material if omitting it or misstating it could influence decisions that the primary users of general purpose financial reports make on the basis of those reports, which provide financial information about a specific reporting entity. In other words,

materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report².

28. While of course the definition of materiality included in the conceptual framework relates to financial information/reporting, the concept may be analogised for the purposes of these draft guidelines and the Prospectus Regulation considering the addressees or the readers of a prospectus (i.e. Information is material if omitting or misstating could negatively influence investment decisions based on the use of a prospectus). As such, persons responsible for the prospectus may use this guidance when assessing the materiality of a risk factor. Similarly, national competent authorities may use it when reviewing the risks factors in particular when the description of the risk factor includes quantitative information.

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

Where available, the disclosure of quantitative information, in order to illustrate the potential negative impact of a risk factor should be included. However, where quantitative information is not available, the description of the potential negative impact of the risk factors may be described using a qualitative approach.

For example, in relation to qualitative disclosure, to the extent it is explained how the risk factor affects the issuer or the securities one option for the presentation of the materiality of risk factors may be by reference to the scale of low, medium or high as per Article 16(1) subparagraph 3 of the Prospectus Regulation. However, the persons responsible for the prospectus are not obliged to provide such a scaled ranking of risks according to their materiality. The potential impact of the risk factor needs to be disclosed in any case.

29. As a means of demonstrating the materiality of a risk factor by virtue of its potential negative impact, where available, ESMA welcomes the disclosure of quantitative information in order to illustrate this potential negative impact. This quantitative information may be complemented, where necessary, with qualitative information. However, where quantitative information is not available persons responsible for the prospectus should include qualitative information that could demonstrate how the issuer/guarantor or the security is affected, or to which extent it is exposed to the relevant risk factor.

30. In this respect, ESMA notes that in other European legislation³ issuers are already required to provide quantitative disclosure and information concerning financial risks,

² Paragraph 2.11 of the IFRS Conceptual Framework.

³ Such as for instance Regulation No (EC) 1606/2002 (IFRS as endorsed by the EU).

and as such this disclosure could be tailored for the purpose of including it in the prospectus, in order to illustrate the risk that the investors may incur when purchasing securities issued using a prospectus. ESMA reminds the persons responsible for prospectus that while the information disclosed for the purpose of other European legislation, such as in IFRS 7 *Financial Instruments Disclosures* as endorsed by the EU, may be of assistance to ensure that risk factors are material and specific, the description of risk factors should be concise and focused and appropriate for the target group of the prospectus. Therefore, ESMA does not consider it appropriate to reproduce the full content of such disclosures into the risk factors section.

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

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

Where mitigating language is included in relation to a risk factor, it can only be used in relation to illustrate its probability of occurrence and the expected magnitude of its negative impact.

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.

31. Under the current prospectus disclosure regime it has been noted that mitigating language is often included in relation to risk factors. If the competent authority believes that mitigating language included in the prospectus renders the relevant risk factor immaterial, the competent authority should require the persons responsible for drawing up the prospectus to amend the mitigating language. The idea behind a prospectus, RD or URD containing risk factors is that an investor is fully aware of the inherent risks associated with their prospective investment and therefore it stands to reason that mitigating language cannot be used to undermine the principle of 'risk' attached to purchases of the relevant securities.
32. While it may be relevant for the persons responsible for the prospectus to refer, for example, to risk management practices that may decrease the perceived probability of the occurrence of a risk, or that may decrease the magnitude of the negative impact of the risk; lengthy descriptions of risk management practices should not be included in

the risk factors section of the prospectus, RD, URD as they might obscure the risk factor or render it immaterial. While ESMA is not of the view that mitigating language such as risk management practices/policies should be proscribed, it should be used carefully when included in a prospectus i.e. it can be included to the extent that it does not negate the risk and where included the significance of the remaining material risk should be made clear.

33. In the example above, mitigating language is used as a general disclaimer concerning risks management practices. The use of such language in this manner reduces the investor's perception of the materiality of the risks to which the issuer is exposed and leaves the remaining risk unclear. For this reason ESMA believes that the use of such language is not appropriate and should not be included within the risk factor disclosures.
34. As a general principle, ESMA believes that the same idea should apply to mitigating language as a whole and not only to language which reflects risk management practices of the issuer.

QUESTIONS FOR CONSULTATION

- Question 2: Do you agree with the suggested draft guideline 3? If not, please provide your reasoning.
- Question 3: Do you agree with the suggested draft guideline 4 on quantitative information? If not, please provide your reasoning.
- Question 4: Do you agree with the suggested draft guideline 5 on mitigating language? If not, please provide your reasoning.

6.3. Corroboration of the materiality and specificity

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

While direct/clear corroboration of the materiality and specificity of the risk factor is normally demonstrated via the inclusion of 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.

35. In order for a risk factor to be included in the prospectus the information contained in the prospectus should corroborate that the risk factor is material and specific to either

the issuer/guarantor or the securities, so that an investor can make an informed investment decision.

36. For example, an issuer may disclose in the risk factors that its financial performance is particularly dependent on a given geographic or business segment, and consequently changes to the economic environment in that geography/profitability of that segment for instance due to competition or a particular proposed new regulatory requirement may have up to 30% negative impact on the distribution of dividends to shareholders. Although a description of the percentage of the turnover sales arising from that geography /profit of the segment may not necessarily be referred to in the risk factor description, such a trend could be identified by virtue of a review of the financial statements notably in relation to segment reporting information where quantitative information is disclosed, the business overview or the trend disclosures included in the prospectus. In this regard a reference may be provided in order to facilitate easier access to the relevant information.
37. While a guideline linked to the time assessment of materiality has not of itself been drafted, ESMA wishes to highlight that the concept of materiality may be affected by the passage of time. For instance, materiality changing over time is a matter well reflected in the context of base prospectus updates. When submitting a base prospectus for approval, in advance of the expiry of the period of validity of a previous base prospectus, the person responsible for the prospectus should consider whether the risk factors contained in the document are still relevant. When submitting a securities note or tripartite prospectus for approval, the person responsible for the prospectus should consider whether the risk factors contained in the RD/URD are still relevant.
38. Where the competent authority has reason to believe that the risk factor is no longer relevant because of changes elsewhere in the prospectus, the competent authority may challenge the inclusion of the risk factor.

QUESTIONS FOR CONSULTATION:

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

6.4. Presentation of risk factors across categories

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

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.

In accordance with Article 16 of the Prospectus Regulation, the most material risk factors must be presented first in each category, but it is not mandatory that all further risk factors within each category must be ranked in order of their materiality.

Risk factors 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.*

Risk factors 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.*

39. Under the current prospectus regime, it has been noted that numerous risk factors are presented without any particular structure and without any indication as to the order of presentation (most material risk factor being placed first) among them based on their associated risk. To remedy this present situation and ensure a structured approach, as envisaged by Article 16(1) subparagraph four, ESMA proposes these draft guidelines on presentation of risk factors across categories to serve as an aide in relation to the comprehensibility of risk factors.

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

Headings should reflect the nature of the risk factors. When presenting headings it should be ensured that they are easily identifiable in the prospectus, through the use of appropriate spacing and bold font.

A category should not be included when it is not relevant. Where a risk factor, or risk factors are similar in nature, they can be arranged and presented under the same heading.

40. The requirement for the use of headings is helpful from the perspective of producing a user-friendly prospectus. In their review, competent authorities should always take into account the end-user: the investor. The investor will benefit greatly when presented with a risk factor section which is structured and coherent. Accordingly, ESMA has drafted this guideline to provide competent authorities with a mechanism to simplify the reading of risk factors.
41. In relation to the arrangement and presentation of risk factors which are similar in nature, the rationale behind the explanatory text emanates from a need to limit the amount of categories contained in the risk factor section. Therefore, where appropriate, similar risk factors should be grouped together and should not be described under a separate category. If one category sufficiently encompasses a type or family of risks, then their descriptions should fall thereunder.

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

ESMA considers that including more than ten categories in the case of a standard, single-issuer, single-security prospectus, would go beyond the requirement in Article 16(1) of the Prospectus Regulation which states that the ‘risk factors shall be presented in a ‘limited’ number of categories’’. This figure of up to ten categories should be reduced where such a number of categories is not relevant or, in other circumstances, it could be extended depending on the case. ESMA understands the case of a multi-product base prospectus as an example where further categories may be relevant.

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

42. ESMA notes that the idea of producing a numerical illustration of what should be considered as a suitable amount of risk factor categories, for the purpose of determining proportionality, might be considered as either too restrictive or too lenient. In light of this, the question of proportionately should be determined on a case-by-case basis. The Level 1 requirement in relation to categorisation refers to the number of categories being ‘limited’. Taking into account that certain prospectuses may be particularly large, due to the fact that there may be a number of securities offered, or that there may be a guarantor for some of the securities, etc. the intention with this guideline is to build upon the Level 1 principle while still providing some flexibility.
43. ESMA considers that the reference to a limit of ten categories is reasonable for the purpose of the example cited in the explanatory text. However, ESMA highlights that there may be departures from this number provided on the basis that there are justifiable grounds for such.

Guideline 10: Categories should only be further divided into sub-categories in cases where sub-categorisation can be justified on the basis of the particular

type of prospectus. Competent authorities should challenge the use of sub-categories in the risk factors section in other circumstances.

Sub-categories should only be used where their inclusion can be justified on the basis of the particular type of prospectus. For example, in the case of a base prospectus containing multiple types of securities, sub-categories might be necessary for the presentation of risk factors.

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.

QUESTIONS FOR CONSULTATION

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

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.

6.5. Focused/concise risk factors

Guideline 11: Competent authorities should ensure that the disclosure of each risk factor is presented in a concise form. Where this principle is not complied with, competent authorities should challenge the wording and request more focused disclosure.

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

44. This guideline has been drafted as a logical consequence of a need to refine the volume of disclosure contained in descriptions of risk factors, to only that information which is necessary for assessing the risks presented to the investors. Without a tool allowing for such a refinement, competent authorities have little scope to address this matter and to request more concise disclosure.
45. In light of the above, this guideline presents competent authorities with a mechanism to ensure that investors avoid being confronted with the laborious task of sifting through content which obscures the perception of risk, simply by virtue of the weight of unnecessary disclosure within which the risk has been presented.

46. For instance, it has been noted that credit institutions exposed to bail-in risk oftentimes produce a number of pages of disclosure surrounding the BRRD⁴ as a whole. If such a risk factor is relevant for inclusion, in accordance with Article 16 of the Prospectus Regulation and these draft guidelines a competent authority or investor should not expect to see background information concerning the origin of this EU-wide directive generally, but more importantly, the competent authority or investors should be made clearly aware of the measures which may be exercised pursuant to the BRRD and the likelihood of one of these measures being exercised in the context of the particular issuer and its specific circumstances. Overall, the requirements of this draft guideline encompass the various elements of the draft guidelines presented throughout this paper i.e. materiality, specificity, etc.

QUESTION FOR CONSULTATION

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

6.6. Risk factors in the summary

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

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

QUESTIONS FOR CONSULTATION

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

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?

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.

⁴ Bank Recovery and Resolution Directive.



Annex I: List of questions for consultation

Specificity

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

Materiality

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

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

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

Corroboration

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

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.

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.

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.

Summary

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

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?

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.



Annex II: The draft guidelines on risk factors

I. Scope

Who?

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

What?

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

When?

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

II. References and Definitions

Legislative References

Prospectus Regulation (PR)

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

ESMA Regulation

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

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

In addition, the following definitions apply:

Persons responsible for the prospectus

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



responsible for the information given in the prospectus and identified as such in the prospectus

URD

Universal registration document as defined in Article 9 of the Prospectus Regulation

RD

Registration Document

III. Purpose

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

IV. Compliance and reporting obligations

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

Reporting requirements

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



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

V. Background

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

VI. Draft guidelines on risk factors

VI.1. Draft guidelines on Specificity

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

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

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

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

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

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

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

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

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

- 1) The degree of liquidity of such securities:

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

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

The subordinated notes constitute unsecured debt claims over Bank ABC.

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

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

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

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

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

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

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

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

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

VI.2. Draft guidelines on Materiality

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

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

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

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

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

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

23. Where mitigating language is included in relation to a risk factor, it can only be used in relation to illustrate its probability of occurrence and the expected magnitude of its negative impact.
24. The following is an illustration of mitigating language which 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.

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

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

25. While direct/clear corroboration of the materiality and specificity of the risk factor is normally demonstrated via the inclusion of 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. Draft guidelines on Presentation of risk factors across categories

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

26. The categorisation of risk factors and the ordering of risk factors within each category should support their comprehensibility. Both should assist investors in understanding the source and nature of each disclosed risk factor. A risk factor should only appear once, in the most appropriate category.

27. In accordance with Article 16 of the Prospectus Regulation, the most material risk factors must be presented first in each category, but it is not mandatory that all further risk factors within each category must be ranked in order of their materiality.
28. Risk factors specific and material to the issuer/guarantor could, for 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.
29. Risk factors 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 ensure that each of the categories are identified within the risk factors section of the prospectus via the use of appropriate headings.

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

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

32. ESMA considers that including more than ten categories in the case of a standard, single-issuer, single-security prospectus, would go beyond the requirement in Article 16(1) of the Prospectus Regulation which states that the 'risk factors shall be presented in a 'limited' number of categories''. This figure of up to ten categories should be reduced where such a number of categories is not relevant or, in other circumstances, it could be extended depending on the case. ESMA understands the case of a multi-product base prospectus as an example where further categories may be relevant.

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

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

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

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

Guideline 11: Competent authorities should ensure that the disclosure of each risk factor is presented in a concise form. Where this principle is not complied with, competent authorities should challenge the wording and request more focused disclosure.

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

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

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

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