

# ESMA'S CONSULTATION ON DRAFT GUIDELINES ON RISK FACTORS UNDER THE PROSPECTUS REGULATION

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## AMAFI's contribution

Association française des marchés financiers (AMAFI) is the trade organisation working at national, European and international levels to represent financial market participants in France. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI's members operate for their own account or for clients in different segments, particularly organised and over-the-counter markets for equities, fixed-income products and derivatives, including commodities. Nearly one-third of its members are subsidiaries or branches of non-French institutions.

For over three years, AMAFI has been paying close attention to progress in the Capital Markets Union (CMU) initiative and, within such initiative, to the proposals which aimed at revising the Prospectus Directive with a view to making it easier and cheaper for companies, and in particular smaller companies, to access capital and improve prospectus accessibility for investors.

Having contributed to the two EC Consultations of May 2015 on its Green Paper on Capital Market Union ([AMAFI / 15-28](#)) and on the review of the Prospectus Directive ([AMAFI / 15-27](#)) and having then contributed to the three ESMA consultations on draft regulatory and technical advice relating to the Prospectus Regulation of September 2017 ([AMAFI / 17-61](#)) and March 2018 ([AMAFI / 18-14](#)), AMAFI is now keen to contribute to the consultation launched by ESMA - on 13 July 2018 until 5 October 2018 – on its **draft Guidelines on risk factors under the Prospectus Regulation**.

You will find below AMAFI's responses to the questions raised by ESMA.

## A. Specificity

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

**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.

Article 16 of the Prospectus Regulation (PR) requires that the risk factors featured in a prospectus be “specific” to the issuer and/or to the securities. This means that they should be relevant to the issuer, as indicated by ESMA in its explanations. Among these risks that are relevant to the issuer, they may be risks that are unique to the issuer but others, such as risks factors related to the issuer’s industry, which are not unique but are just as relevant to the issuer as they are relevant to all issuers across that industry.

AMAFI agrees that there should be a “clear” link between the risk factor and the issuer, guarantor or securities but fears that the adjective “direct” be misconstrued by the NCAs. Surely, what ESMA calls “boiler-plate” risks should be excluded but not the industry specific risks which may be shared with other issuers but remain nevertheless “specific” to the issuer.

AMAFI would like the Guidelines to be modified to remove the word “direct” and express clearly what is set above, the key word being that the risks factors must be “relevant” to the issuer, guarantor or 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 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.

AMAFI strongly disagrees with the last sentence of Guideline 2. If the competent authority may challenge any aspect of the prospectus and require an amendment, a clearer explanation or a further disclosure, it should not be given the authority to refuse to approve a prospectus, just because the NCA considers (in a subjective manner) that “*specificity is not apparent from the disclosure of the risk factor*”.

It should be recalled that the relevant persons responsible for the contents of a prospectus, namely the issuer and its directors, have potential legal liability to investors for the accuracy and completeness of the prospectus (and particularly in the context of large international offerings of securities, the risk may be quite high of legal action being brought against issuers and their directors on the basis of a range of country’s laws before several jurisdictions, including in the U.S.). In contrast, NCAs who will use the proposed Guidelines in their review of the “specificity and materiality” of risks factors do not accept responsibility to investors for the prospectus and furthermore are protected by statutory immunity.

Given that situation, if a discussion (a challenge) and additional requests are part of a fair process, the issuer should, at the end of the day, be able to decide which relevant and material risks factors it wishes to disclose for which it may face legal action and potential liability.

## B. Materiality

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

**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.

AMAFI reiterates its comments in relation to Guideline 2 above. Given the liability that may be potentially incurred by the issuer and its directors in relation to the accuracy and completeness of the prospectus, the last sentence of Guideline 2 should be removed.

AMAFI also questions the reference, in ESMA's explanations, to the IFRS definition of materiality which was developed specifically for financial reporting but does not appear to be relevant or appropriate when assessing the materiality of a risk factor. Such reference should not be kept in the future Guidelines.

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

**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

AMAFI is worried about ESMA's indication that "*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 the qualitative approach*".

Indeed, while Level 1 rules do not require the disclosure of quantitative information, this statement may encourage the NCAs to systematically require it, alleging that it can be put together easily, which in fact is not the case. In addition, providing quantitative information is likely to generate significant costs for the issuer as such quantitative data would have to be verified by the auditors. Also, disclosing existing quantitative data used for internal purposes could have a negative impact on the business secrecy which is key for the issuer.

Such statement also creates a hierarchy between quantitative and qualitative information which does not exist either in the Level 1 rules. Article 16 (1) of the PR only requires an adequate description of each risk factor and states the "*assessment of the materiality of the risk factors may also be disclosed by using a qualitative scale of low, medium or high*".

Therefore, AMAFI would like the sentence appearing in italics in the first paragraph above to be removed from the future Guidelines. NCAs should be encouraged to have flexibility regarding the way in which the potential negative impact of the risk factor on the issuer/guarantor and/or the securities is disclosed.

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

**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.

AMAFI does not have any comment in relation to Guideline 5.

### **C. Corroboration of the materiality and specify**

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

**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.

AMAFI reiterates its comments in relation to Guidelines 2 and 3 above (see Questions 1 and 2). Given the liability that may be potentially incurred by the issuer and its directors in relation to the accuracy and completeness of the prospectus, the last sentence of Guideline 6 should be removed.

### **D. 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.**

**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.

AMAFI reiterates its comments in relation to Guidelines 2, 3 and 6 above (see Questions 1, 2 and 5). Given the liability that may be potentially incurred by the issuer and its directors in relation to the accuracy and completeness of the prospectus, the last sentence of Guideline 7 should be removed.

Regarding the categories which are proposed, AMAFI considers that they are acceptable provided that they are proposed, as mentioned, “*as an example*”, and not in a rigid way which would make it mandatory to have exactly these categories and in the same order. In fact if roughly, the proposed categories are those commonly used in practice, the order in which they are presented is not the usual order which is most commonly used. The explanation attached to the future Guideline 7 should therefore be clarified to ensure that there will be no possibility for the NCAs to impose, and in that order, what is allegedly proposed as an example.

**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.

AMAFI agrees with the drafting of Guideline 8.

**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.**

**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.

AMAFI agrees with the drafting of Guideline 9 and with the drafting of the following paragraph in the Consultation Paper, which suggests flexibility in the appreciation of the number of categories to be used, as it is stated that the figure of 10 categories should be reduced in certain circumstances but may also be extended in others. The flexibility is very important to adapt the number of categories to the size and complexity of the issuer and the transaction.

**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 subcategories in the risk factors section in other circumstances

AMAFI does not have any particular comment in relation to Guideline 10.

## **E. 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.**

**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.

AMAFI is surprised by this Guideline which is not in the scope of the guidelines for which ESMA has been given a mandate, under article 16(4) of the PR (*“ESMA shall 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”*).

If, in principle, requesting that risk factors be presented in a *“focused/concise”* way is logical, NCAs should not be encouraged to require concision to the detriment of comprehensibility. AMAFI does not see in any case the benefit of this Guideline, given that article 6 (2) of the PR contains a general statement applicable to all disclosures made in the prospectus which is drafted in a more balanced way, with the adjectives *“easily analysable, concise and comprehensible”*. This is sufficient and constitutes one more reason why this Guideline should be removed. If ever it was kept, it should be amended to aim at maintaining a good balance between concision and comprehensibility.

## **F. Risk factors in the summary**

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

**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.

AMAFI does not have any particular comment in relation to Guideline 12.

## G. 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?**

AMAFI agrees with some of the proposed draft guidelines, to the extent mentioned in its answers to Questions 1 to 9 above.

It would like to stress out the importance of the liability issue for the issuer (and its directors) (as mentioned in relation to Guidelines 2, 3, 6 and 7 in, respectively, Questions 1, 2, 5 and 6 above). The necessary consequence of this potential liability is that the issuer, after a fair discussion, if necessary, with the NCA, should be allowed to make its own judgment and decision as to the way in which a disclosure should be made in the prospectus. The Guidelines should expressly mention this point so as to ensure that it is taken into account by the NCAs in due course.

**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.**

AMAFI, as a professional organization, is not in a position to estimate the cost incurred by its members in connection with the proposed Guidelines. When such Guidelines reflect accurately the requirements set out in the Level 1 rules, there should not be significant additional costs. However, when an additional requirement is prescribed, it will necessarily generate additional costs. This would certainly be the case if quantitative information to illustrate the potential negative impact of a risk factor were required. Please refer to AMAFI's comment in relation to Guideline 4 in Question 3 above (with the mention, *inter alia*, of the statutory auditors' costs that would be required in that case).