



Quoted Companies Alliance

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ESMA
CS 60747 – 103 rue de Grenelle
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5 October 2018

Dear Sirs,

Guidelines on risk factors under the Prospectus Regulation

We welcome the opportunity to respond to ESMA's consultation paper on Guidelines on risk factors under the Prospectus Regulation.

The Quoted Companies Alliance *Legal* and *Primary Markets Expert Groups* have examined your proposals and advised on this response. A list of Expert Group members can be found in Appendix A. We have responded below in more detail to the specific questions from the point of view of our members – small and mid-sized quoted companies.

However, overall, we have three principal comments on the guidelines:

- **Specificity:** We are concerned that the proposed guidelines ignore the fact that some risk factors may apply to a wide range of companies, yet still be specific to each individual company. We believe that the inclusion of so-called boilerplate or generic risk factors should only be challenged if they are not actually relevant to the issuer of its securities.
- **Using the IFRS definition of materiality:** We question the rationale of this choice when the Prospectus Regulation already sets out its own materiality test for information to be included in prospectuses. We recommend that ESMA instead uses the test of materiality for risk factors outlined in Article 6(1) of the Prospectus Regulation.
- **Quantitative information:** Assessing a risk's materiality can be extremely difficult given the uncertainty regarding the probability and timing of their occurrence. Requiring quantitative information on the potential impacts of a risk factor will therefore be particularly challenging for smaller issuers, whose risks are rapidly changing and evolving, and should therefore be removed from the guidelines. We note that the Level 1 text of the Prospectus Regulation only refers to "qualitative information" which may be disclosed to illustrate materiality – such information is not mandatory.

The Quoted Companies Alliance is the independent membership organisation that champions the interests of small to mid-size quoted companies.

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If you would like to discuss our response in more detail, we would be happy to attend a meeting.

Yours faithfully,

A handwritten signature in blue ink, appearing to read 'TW', with a stylized flourish extending to the right.

Tim Ward

Chief Executive

A. Specificity

Q1 Do you agree with the suggested draft guidelines on specificity? If not, please provide your reasoning.

Although we agree that the risks disclosed in a prospectus should be specific to the issuer, we are concerned that the suggested draft guidelines on specificity ignore the fact that some risk factors may apply to a wide range of similar companies, yet still be specific to every one of those companies.

The guidelines, as currently drafted, are written with the presumption risk factors are always binary, being either general or specific, but not both. Yet, certain risk factors relating to an industry or market sector may be relevant for all issuers operating in that space and, if so, should also be included— notwithstanding that they may also be included in many other prospectuses. Therefore, we recommend ESMA clarify the approach issuers should take in this regard.

Specifically, the inclusion of boilerplate or generic risk factors should only be challenged if they are not relevant to the issuer or its securities. The guidelines should recognise that there are certain generic risk factors which will be relevant to all prospectuses for a particular type of security and consequently, they should be included if relevant.

B. Materiality

Q2 Do you agree with the suggested draft guideline 3? If not, please provide your reasoning.

We question why ESMA wishes to adopt the IFRS definition of materiality which relates to financial reporting when the Prospectus Regulation sets out its own materiality test for information to be included in prospectuses.

We suggest that the appropriate test of materiality for risk factors is set out in Article 6(1) of the Prospectus Regulation which provides that a prospectus shall contain the necessary information that is material to an investor for making an informed assessment of various factors, including the nature of the issuer and the type of securities.

Consequently, this should be the appropriate test, read together with the specific requirements in Article 16(1), so that only risks which are specific to the issuer and/or to the securities and which are material for taking an informed investment decision are included.

Q3 Do you agree with the suggested draft guideline 4 on quantitative information? If not, please provide your reasoning.

Assessing the materiality of risks can be very challenging, given their differing variables with respect to probability and timing of their occurrence. Such judgements are often subjective: what is a material risk to one investor may not be to another and vice-versa. Therefore, disclosing quantitative information on the potential impacts of a risk factor will be challenging for smaller issuers, whose risks are rapidly changing and evolving.

Article 16(1) of the Prospectus Regulation only refers to "qualitative information" which may be disclosed to illustrate materiality – but it is not mandatory to include such information. The Level 1 test does not refer to

"quantitative information" at all so we question whether ESMA has the mandate to encourage the disclosure of quantitative information "where available" in order to illustrate the potential negative impact of a risk.

The guidelines seem to suggest that if quantitative information is available, then this should always be provided instead of qualitative information as a default position. This does not reflect the position set out in Article 16 of the Prospectus Regulation. It is also not clear from the guidelines as to what is meant by "quantitative information".

Furthermore, in reality, the suggested draft guideline 4 on quantitative information is unlikely to be used instead of the qualitative scale of "low", "medium" or "high". A likely consequence of this is that these qualitative options will become the default option as a simple preservative mechanism against liability.

Q4 Do you agree with the suggested draft guideline 5 on mitigating language? If not, please provide your reasoning

No – we do not agree with the suggested draft guideline 5 on mitigating language.

It is a fundamental part of any issuer's risk management systems to take all economically practical steps to mitigate the risks that the company is exposed to. Placing a prohibition on a company explaining how it seeks to mitigate the risks that it faces can only serve to give a distorted view of the actual residual risk that it, and by extension its investors, face. This could lead to situations where investors do not receive all of the information that they require, in order to make an informed investment decision.

C. Corroboration

Q5 Do you agree with the suggested draft guideline 6 on corroboration of specificity and materiality? If not, please provide your reasoning.

Although we agree with the suggested draft guideline 6 on corroboration of specificity and materiality in principle, we believe that it may lead to national competent authorities requiring the stated risk factors to be repeated throughout the prospectus to ensure clarity of the corroboration.

D. Presentation of risk factors across categories

Q6 Do you agree with the suggested draft guidelines on Presentation of risk factors across categories? If not, please provide your reasoning.

Although we agree with the suggested draft guidelines on Presentation of risk factors across categories in principle, we believe that the example categories given are likely to become the default categories in practice irrespective of the size or complexity of the issuer.

Q7 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.

We do not consider the imposition of an arbitrary limit on the number of categories to be included in a risk factor to be either helpful or necessary. It is likely to result in difficulties for a complex issuer, whereby the number of risk categories may exceed the number of risks permitted to be disclosed in the summary.

We note that ESMA identifies nine risk categories in draft guideline 7. This would leave issuers little scope to add other risk categories that could be relevant considering the nature of the issuer and/or its securities.

E. Focused/concise risk factors

Q8 Do you agree with the suggested draft guidelines on focused/concise risk factors? If not, please provide your reasoning.

In the first instance, we believe that ESMA should provide justification for its belief that the “size inflation” of risk factors is not necessary for assessing the risk presented to investors. This should also be complemented by an explanation of how national competent authorities should address this issue.

F. Summary

Q9 Do you agree with the suggested draft guideline on risk factors in the summary? If not, please provide your reasoning.

Yes – we generally agree with the suggested draft guideline on risk factors in the summary.

However, due to the limits imposed on the number of risks in a prospectus by the Prospectus Regulation, we believe that there should be more guidance as to how the assessment to determine the most “material” risk should be made.

G. General

Q10 Do you agree with the proposed draft guidelines? Have you any further suggestions with regard to draft guidelines addressing a particular section or the guidelines in general?

We have no comments.

Q11 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.

Yes - market participants will bear any additional cost as an indirect effect of the suggested draft guidelines. The main driver of this will be the extension of timetables required to negotiate the limiting of risk factors in prospectuses with the national competent authority and the resulting increase in draft prospectuses submitted.

Quoted Companies Alliance Legal Expert Group

Mark Taylor (Chair)	Dorsey & Whitney
Maegen Morrison (Co-Deputy Chair)	Hogan Lovells International LLP
Stephen Hamilton (Co-Deputy Chair)	Mills & Reeve LLP
Murdoch Currie	Bates Wells & Braithwaite LLP
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Andrew Buchanan	Canaccord Genuity Ltd
David Foreman	Cantor Fitzgerald Europe
Stephen Keys	Cenkos Securities PLC
Peter Stewart	Deloitte
Stuart Andrews	finnCap
Samantha Harrison	Grant Thornton
Niall Pearson	Hybridan LLP
Richard Crawley	Liberum Capital Ltd
Tom Price	Northland Capital Partners Limited
George Sellar	Peel Hunt LLP
Peter Whelan	PricewaterhouseCoopers LLP
Mark Percy	Shore Capital Group Ltd
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Andy Crossley	Stockdale Securities Limited
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