

UKLA Technical Note

Risk factors

Ref: UKLA / TN / 621.3

s 87A(3) FSMA,
LR 7.2 and PR
Appendix 3
Annexes

The Prospectus Directive and requirements under FSMA

The Prospectus Directive (PD) requires all issuers to include disclosure on risk factors in the prospectus. The disclosure is driven by the relevant Annex disclosures and is therefore dependent on the issuer, its industry and the securities being offered to the public or admitted to market.

In addition, Section D, Annex 22 of PR Appendix 3 requires summaries to contain prominent disclosure of key risks, as required by the relevant Annexes.

While the requirements, as laid out in the Annexes, are broadly drafted and do not prescribe the type of risk factors that should be included (although a prescribed statement is required in relation to derivatives – see Annex 12), they do state that the risk factors should be specific to the company and its industry, and should be relevant to the type of securities being offered.

These disclosure requirements are important to emphasise, as we believe that there is a tendency for risk factor sections to include more generic, standardised risk factors, which do not appear to be directly relevant for the company or the issue that is the subject of the document.

It is also important to highlight the overarching requirements of section 87A(3) FSMA, which requires the information to be presented in a form that is comprehensible and easy to analyse.

Disclosure of risks in the prospectus summary

Section D, Annex 22 of PR Appendix 3 requires a prospectus summary to disclose only key information on the key risks to the issuer, its industry and its securities. This requirement is distinct from the PD requirement to disclose 'material' risks in the risk factor section. Consequently, a different materiality test applies for risk information that is required to be disclosed in the summary as compared to the risk factors section of the prospectus.

In distinguishing key risks we recognise market participants' concern that this split of risks could de-emphasise those not identified as key. However, we do not consider this to be an acceptable argument for the inclusion of non-key risks in a summary, noting also that the PD requires summaries to be concise and contain only key information.

To address the potential liability concern, the following statement may be included in the preamble to the risk factors section of a prospectus:

'Prospective investors should note that the risks relating to the Group, its industry and the Ordinary Shares summarised in the section of this document headed 'Summary' are the risks that the [Directors believe /the Company believes] to be the most essential to an assessment by a prospective investor of whether to consider an investment in the Ordinary Shares. However, as the risks which the Group faces relate to events and depend on circumstances that may or may not occur in the future, prospective investors should consider not only the information on

the key risks summarised in the section of this document headed “Summary” but also, among other things, the risks and uncertainties described below.’

Where included, the above wording should be tracked in full. However, the reference to Ordinary shares may be amended in order to address the transferable securities the subject of the prospectus to which Annex 22, section D is being applied.

We will challenge issuers if key risks are not adequately described or if it appears that non-key risks have been disclosed in the summary.

Our approach to risk factors sections in documents

We believe that issuers are best placed to assess the material risks that are relevant to them, their industry and the specific issue of securities. We are also mindful of the prospectus responsibility regime, where the document is the responsibility of the issuer and its directors. Therefore, we do not routinely request that risk factors are substantially redrafted or removed from a prospectus.

However, we will challenge risk factors in certain situations as part of our day-to-day vetting, for example:

- where disclosures conflict with or undermine other rule requirements (eg, by qualifying the working capital statement with references to the requirement for further additional funding in the near future)
- where disclosures conflict with an issuer’s eligibility or continuing obligations (eg, detriment to investors, shares in public hands, etc)
- where disclosure is contradictory to applicable Listing or Premium Listing Principles (eg, Listing Principle 1, maintaining adequate systems, procedures and controls)
- where sufficient prominence is not given to material risks
- where there is disclosure elsewhere in the document that seems to clearly present a risk to the issuer, which has not already been disclosed in the risk factor section and
- where the risk factors are simply statements of fact that contain no explanation of the risk in the context of the issuer’s business or the issue of the securities in question.

Proper consideration should be given to the real risks that face an issuer and that generic or boilerplate disclosure is avoided. If risks are not relevant to a particular issuer then no disclosure on that issue should be included in the issuer’s document. Risk factors should be grouped together in a coherent manner and risk factors considered to be of the greatest or most immediate significance should be prominent at the beginning of each section or group within the risk factors section.

We will generally not challenge risk factors that contain information on mitigating factors provided that the inclusion of such information does not confuse the nature of the risk or its materiality. Where a prospectus is specifically precluded from including information on risk mitigation – for example, due to US disclosure requirements – then this information may be appropriately disclosed elsewhere in the document.