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Subject: **ESMA31-62-996 (Consultation Paper on *Guidelines on Risk Factors*)**

Author: **Iñaki Viggers San Mamés**

Introduction

Consultation Paper ESMA31-62-996 readily reflects ESMA's intent to eliminate redundancy and obfuscation in issuers' subsequent disclosures of risk factors. With that in mind, Iñaki Viggers hereby outlines improvements to the draft, and also proposes additional information that the competent authority should gather for the benefit of analysts and investors. That additional information is devised to help investors (1) identify their specific hedging needs in the regard to the issuer or security, and (2) assess two crucial aspects about issuer's management: its effectiveness, and its reliability in the sense of transparency. In all other respects, the draft Guidelines on risk factors seems functional[1].

I. *Up-to-Date* Disclosures of *Current* Risk Factors: Guidelines 1, 6.

The explanatory text of Guidelines 1 and 6 highlight the importance that only *current* risk factors be included in the disclosure. For instance, see CP.17 pursuant to Guideline 1 (containing "*previously*" and *"if they are not relevant*" in its language), and CP.37 pursuant to Guideline 6 (alluding to "*time assessment*", and requiring that the risk factors disclosed be "*still relevant*"). Nevertheless, the language in the draft Guidelines itself surprisingly does not capture that aspect. The language of "*corroboration*" in Guideline 6 might not necessarily reflect the timeliness of the risk factor being disclosed.

The need for disclosure only of *current* risk factors is certainly a matter of common sense. As such, it does not strictly warrant mention in the Guidelines. However, briefly highlighting the requirement that the disclosure be *up-to-date* --and only of *current* risk factors-- contributes to avoid that investors' analyses become needlessly convoluted for having to process irrelevant information.

[1] Citations of the Consultation are made using format *CP.n*, where number *n* refers to the *n*th item (not the page number) of the Consultation Paper.

II. Mitigating Language, and Recycling/Boiler-Plate Risks: Guidelines 1, 5.

CP.31 warns against the practice of including mitigating language that "*undermine[s] the principle of 'risk' attached to purchases of the relevant securities*". It is noteworthy that this caution is relevant not only to *purchases*, but also to the investor's *continued holding* of his position. As such, the investor has a legitimate interest in learning how the issuer is planning to address the disclosed risk factors.

Although mitigating language is not proscribed altogether (CP.31), the draft provides no guidelines on the *correct usage and extent* of mitigating language. Thus, this Consultation is the right occasion to propose the following criterion:

> **Mitigating language is permissible *only to the extent* that its specificity enables an investor to identify whether he needs to hedge his position.**

The mitigating language, if any, should consist of reasonably announcing concrete actions by which the issuer intends to reduce exposure. The example given in the explanatory text of Guideline 5 illustrates mitigating language which is useless to the investor who seeks to identify the issuer's diligence and ability to address risks competently. Indeed, the mitigating language in the example of Guideline 5 does not add transparency and should be stricken as vague.

As an hypothetical example, an airline's disclosure might be:

> "*In the latest six-month period, fuel costs were funded with 50% of the airline's revenues in that same period. But now the recent worsening of the international conflict in Middle East has rendered oil prices a prominent risk factor*".

By adding mitigating language, for instance, in the sense that "*the airline will therefore assume a long position in a forward contract on oil*", the investor will be able to make an informed decision on whether to (1) make no changes to his portfolio; (2) hedge against an upside risk of oil (if he considers likelier that the airline may end up with significant, net outflow of cash at the end of the forward contract); or (3) sell his airline shares. Alternatively, should the mitigating language announce the airline's plans to purchase *call options* of oil, the investor might deem it safe to rule out (2) from among his possible decisions.

Apropos of CP.17 and .19, the criterion as proposed herein also hinders the practice of recycling boiler-plate language not only because of the requisite specificity, but also because the criterion places the investor in a position to assess the issuer's effectiveness in handling the risk factors from previous disclosures. That criterion will encourage issuers to be more judicious because a recycling of non-routine risks may ultimately reflect as issuer's inability or inefficiency in addressing those risk factors.

III. Categorization of Risk Factors: Guidelines 2, 7-10.

CP.21 reflects that Guideline 2 also contemplates *routine risks*. Thereafter, Guidelines 7 through 10 place excessive focus on categorization (and on the appropriate number of categories) of risk factors by their type. The suggestion in this response is that risk factors be categorized primarily on the basis of whether or not they constitute *routine* risks, rather than on the *type* of risk. This proposed classification helps investors highlight or distinguish what risks are essentially permanent and which ones are particular to the issuer's *current* state of affairs.

Furthermore, the classification/categorization as proposed in this response largely forecloses the ambiguity and need for standardization in how to classify risk factors.

By way of example, the ongoing but *recent* uncertainty surrounding the tariffs that U.S. President Donald Trump introduced on imported iron and steel clearly does not qualify as *routine* risk. By contrast, tariffs insofar as a risk factor materially encompass two or more of the categories outlined in the explanatory text of Guideline 7: "*Risks related to the issuer's business activities and industry*", and "*Legal and regulatory risk*". As a result, some entities might place that risk factor in the former category, whereas others might perceive the latter as more pertinent.

Conclusion.

ESMA's efforts to provide analysts and investors with a concise, up-to-date, material disclosures of issuers's risk factors are commendable.

Iñaki Viggers posits that the *mitigating-language* criterion as proposed in this response deters from much of the improper practices that ESMA has detected in previous disclosures of risk factors. Additionally, the criterion proposed herein tends to (1) facilitate investors' analysis of an issuer's risk factors, and (2) accordingly, to help them outline any remaining hedging needs particular to the issuer or security.

Lastly, the emphasis on categorization of risk factors seems excessive. A better alternative would be to shift the focus to a classification of *routine* vs. *non-routine* risks.