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Market Trends: Risk Factors

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Overview

Securities lawyers instinctively recognize two guiding principles about risk factor disclosure. First, the preparation of a substantive disclosure document will almost invariably require the disclosure of risk factors. Second, the disclosure of risk factors is, in itself, risky.

Risk factor disclosure arises from a need to provide meaningful disclosure and an understanding that disclosure regarding future performance should be accompanied by cautionary statements. Risk factors reflect the well-established common law principle that a projection coupled with an appropriate risk factor "bespeaks caution," and serve as cautionary language for the purpose of the safe harbor established by the Private Securities Litigation Reform Act of 1995 (PSLRA). They also satisfy the requirements of Regulation S-K Item 503(c) (17 C.F.R. § 229.503(c)). Risk factors, correctly drafted and utilized, play an important role in defending against allegations of fraud under the U.S. federal securities laws and enforcement actions by the Securities and Exchange Commission (SEC). Securities lawyers understand that a well written risk factor (or cautionary statement) makes it far more difficult for an investor to put too much faith in a statement regarding the future. See Using Safe Harbors for Forward-Looking Statements and Drafting a Compliant Forward-Looking Statement.

While risk factors serve an important defensive and compliance function, when taken to an extreme the disclosure of risk factors can so thoroughly emasculate an issuer's business disclosures as to make them both unreadable and effectively meaningless. Not surprisingly, the SEC is less likely to comment that an issuer has disclosed too few risk factors than to comment that the risk factors disclosed by an issuer do not effectively convey the actual risks involved in the issuer's operations.

Thus, like many other areas of securities disclosure, the use of risk factors demands a balanced approach. See How to Draft Risk Factors for a Registration Statement and Forward-Looking Statements Safe Harbor Checklist. Recent trends in risk factor disclosure underscore this need for balance.

SEC Requirements

The SEC's Regulation S-K (17 C.F.R. §§ 229.10–.1208) governs much of the non-financial statement information that issuers are required to disclose both in registration statements filed under the Securities Act of 1933, as amended (Securities Act), and in periodic reports, filed under the Securities Exchange Act of 1934, as amended (Exchange Act). Although there are also separate requirements in the offering or periodic report forms themselves, the purpose of the integrated disclosure system under Regulation S-K is to harmonize the information disclosed under both the Securities Act and the Exchange Act. For a further discussion of the U.S. disclosure regime, see U.S. Securities Laws: An Overview.

Item 503(c) of Regulation S-K requires a separately captioned "Risk Factors" section that discusses the most significant risk factors to which the issuer and its business are subject and that make the proposed offering or transaction speculative or risky. The discussion in this section is required to be logically organized and concise and, while not explicitly required, risk factors should be listed in order of importance. Issuers should avoid generic risks that could apply to any business or any offering as they fail to effectively serve any of the functions of the risk factors discussed above. Item 503(c) provides the following specific examples of risk factors that may be applicable to an issuer, though this list is non-exclusive:

- No operating history
- No profitable operations in recent periods
- The issuer's financial position
- The issuer's business or proposed business
- No market for the issuer's common equity securities or securities convertible into or exercisable for common equity securities

When preparing and drafting risk factors disclosure, it is important to remember the following:

- While Item 503(c) refers to risk factors that make an offering speculative or risky, risk factors applicable to a registrant and its business are also required to be disclosed in Exchange Act periodic reports, such as the Annual Report on Form 10-K (10-K). (Smaller reporting companies, as defined under applicable SEC rules, are not required to include a risk factors section in their 10-Ks or Quarterly Reports on Form 10-Q (10-Qs), although many practitioners advise them to voluntarily make such disclosure.) Risk factors disclosed in the 10-K need not be repeated in the 10-Q if nothing has changed, but any material changes in risk factors are required to be disclosed in the 10-Q. See Drafting and Reviewing Form 10-K and Drafting and Reviewing Form 10-Q.

- Significant factors that make an investment in the registrant's securities speculative or risky are required to be disclosed in SEC filings only if material to an investor's decision to purchase or sell securities in the market or to participate in a Securities Act offering. For more on materiality, see "**Materiality**" below.

- Item 503(c) is a principles-based disclosure requirement, in that it requires management to exercise judgment in evaluating the relative importance of information to existing and potential investors. This concept is often overlooked by issuers that seek to disclose every imaginable risk factor. A laundry list of risk factors, particularly if it includes generic risk factors that are not associated with specific aspects of the issuer's risk profile, may do an issuer more harm than good, by obfuscating the risks that investors should be considering.

- Risk factors are required to be disclosed in accordance with the SEC's rule on "plain English". (See 17 C.F.R. § 230.421(d)). See Drafting Form 10—Plain English. Of course, plain English, like beauty, is in the eyes of the beholder. What may seem to be plain English to one writer may not be perceived to be plain English to another. The impact of this requirement relates principally to the time required to clear SEC comments, as it is unlikely that an issuer's liability for a risk factor disclosure will turn on whether the risk factor is written in plain English.

- The five examples of possible risk factors included in Item 503(c) have not been modified since 1964. The list is intended to be illustrative, but at this point, given that more than half of a century has passed since the list was compiled, the list has little bearing on risk factor analysis as the risks for a modern corporation are more numerous and complex.

- Item 503(c) itself, as well as the limited SEC guidance on risk factors offered over the years, provides that a registrant should disclose risks that are specific to the registrant, and should not disclose risks that could apply to any registrant. The SEC frequently makes this point in its comment letters. For an issuer, the key is to tie the risk factor specifically to the issuer's business. Consider, for example, the risk that the issuer is in a competitive industry. The fact that the issuer is in a competitive industry does not distinguish the issuer from countless other companies. Moreover, telling an investor that an issuer is in a competitive market without explaining the nature of the competition and how the issuer intends to deal with this risk tells the investor precious little, if anything. For an issuer in a competitive industry, the risk factor is effective only if it goes beyond explaining the existence of competition to explain how companies compete in the industry and how the issuer fares in light of that competition.

Materiality

The principle of materiality is a cornerstone of federal securities disclosure law. Public companies are required to publicly disclose information to shareholders and potential new investors that will enable them to make an informed decision concerning whether to invest in a company's securities and, if they do invest, how to vote those securities and whether to dispose of those securities.

Rule 405 (17 C.F.R. § 230.405) of the Securities Act and Rule 12b-2 (17 C.F.R. § 240.12b-2) of the Exchange Act define "material" as "those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered."

The SEC's definition is consistent with the materiality standard set forth in two seminal U.S. Supreme Court cases, Basic Inc. v. Levinson, 485 U.S. 224 (1988), and TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976).

The Supreme Court has elaborated that a determination of materiality turns on "whether a reasonable investor would have viewed the non-disclosed information as having significantly altered the 'total mix' of information made available." See Matrixx Initiatives, Inc. v. Siracusano, 131 U.S. 1309, 1321-22 (2011), citing to Basic at 232, internal quotations omitted. For further information on materiality, see Understanding Relevant Laws and Guidance Regarding Materiality, Using Guidelines for Determining Materiality, and Determining Materiality for Disclosure Checklist.

Specificity

While the SEC has indicated that risk factor disclosure should be registrant-specific, many registrants continue to include generic risk factors in their SEC documents. The result is often a lengthy risk factor section, which sometimes obfuscates the more specific and significant risk factors that are applicable to a particular registrant.

For example, a financial institution may include a risk factor stating that its net interest income is dependent on fluctuating interest rates. Such a risk factor would apply to all financial institutions. A more useful risk factor for investors would be a description of how recent changes in interest rates earned on the registrant's interest earning assets, such as loans, and the interest rates paid by the registrant on its deposits and borrowings, have affected the net interest income of the particular institution over the applicable period mandated by the disclosure rules. The registrant's evaluation of how anticipated changes in rates in the registrant's market area may affect future performance should also be considered, and disclosed if material.

While it is often a good starting point for a registrant to review the risk factor disclosure of other companies in its industry, management and its counsel should further analyze the applicability and materiality of those risk factors to the particular issuer, and consider whether there are other risks specifically affecting the particular issuer that warrant disclosure.

Registrants should also resist the temptation to allow risk factors to become stale. There is a tendency to keep risk factors once they are first included in an issuer's filings. However, issues that constitute risks at one point in time may become substantially less, or substantially more, significant as the issuer matures. One key way to avoid allowing risk factors to become stale, in addition to simply adding or removing specific risks, is to consider the ordering of the disclosure of the risks. As time passes, the relative importance of any specific risk to an issuer may change and this change should be reflected by moving the relevant risk up or down in priority within the issuer's disclosure. When ordering risk factors or considering any changes to previous ordering, the issuer and counsel should keep in mind that the magnitude of the risk is not necessarily dispositive of the level of materiality of the risk. For example, if the issuer faces a potentially significant risk (in magnitude terms) that is extremely unlikely to occur, that risk may be ranked lower than a potentially less significant (in magnitude terms) risk that is substantially more likely to occur. The SEC does not specifically require this prioritization of risk factors; however it is strongly considered best practice for all issuers and, in the case of Item 3.D of Form 20-F, has been noted to be "encouraged." Counsel should evaluate the risk factors critically each time they are included in disclosure, both in Securities Act and Exchange Act filings. In addition, at times, a fresh set of eyes reviewing risk factors that have become customary for an issuer may lead to a helpful re-write or re-order experience.

Recent Trends

SEC Guidance

The SEC adopted Regulation S-K Item 503(c) relating to risk factor disclosure in 1964. From 1964 until 2016, the SEC provided only limited guidance outside of the express requirements of Item 503(c) on preparing risk factor disclosure. The SEC staff have not released any compliance and disclosure interpretations (CD&Is) on risk factors. Instead, much of the SEC's interpretive or staff guidance on risk factors since the adoption of Regulation S-K Item 503(c) has focused on specific risk categories and issuer-specific comments contained in SEC comment letters. In 2016, however, the SEC issued a concept release entitled "Business and Financial Disclosure Required by Regulation S-K" (Concept Release). See SEC Release No. 33-10064; 34-77599 (April 13, 2016). The Concept Release provides somewhat broader SEC guidance by suggesting potential ways to improve risk factor disclosure, including posing the question of whether the existing principles-based approach is preferable to a more rules-based one. The Concept Release provides valuable insight into the SEC's views on risk factor disclosure and seeks comments on whether its "business and financial disclosure requirements continue to elicit important information for investors and how registrants can most effectively present this information."

The Concept Release requests comment on specific issues relating to risk factor disclosure including some suggestions that might require significant additional disclosure by certain companies. Some of the SEC's inquiries in the Concept Release include whether the SEC should require issuers to:

- *Explain, for each risk factor, what the company is doing to address that risk*

  If adopted, this would mark a significant departure from the standard risk factor practice insofar as explaining what the company is doing to address a specific risk might be considered mitigating language, which the SEC has not allowed to be included in risk factors.

- *Discuss the probability of occurrence and the effect on performance for each risk factor*

  This practice would facilitate a clearer explanation of the ordering of the risk factors by providing context within which to view each one. Current best practice advises ranking risk factors according to their relative magnitude and likelihood of occurrence, but explaining the cause and effect relationship within the risk factor could make the reason for specific ranking of risk factors more clear, though it would also make the disclosure longer.

- *Describe assessment of risk*

  Allowing companies to explain their individual risk assessment practices as they relate to a given risk factor could provide further clarity on the scope and breadth of a given risk factor and insight into management's perception of the risk; however it may also raise unnecessary concerns or overly emphasize certain risks.

- *Disclose the specific facts and circumstances that make a given risk material to the company*

  A requirement of this type seems to indicate an effort by the SEC to make more clear that, as is accepted best practice now, risk factors must be tailored to the individual company providing the disclosure and that merely providing general risk factors is not sufficient.

- *Present risk factors in order of management's perception of the magnitude of the risk or by order of importance to management*

  Unlike the first bullet in this section, this does not appear to be a substantial departure from current risk factor best practice as it is common to categorize and rank the risk factors based on their magnitude and/or importance.

These and the other risk factor points raised in the Concept Release reveal an inherent conflict between the SEC's dual goals in risk factor disclosure. On one hand, the SEC seeks to ensure companies provide fulsome, useful, and accurate risk factors to potential or current investors. On the other hand, the SEC has previously indicated that it wants such disclosure to be concise and to avoid unnecessarily long and burdensome risk factors sections. New rules requiring a risk factor summary, a description of the steps taken by an issuer to address a risk, or a discussion of the probability of the occurrence of each risk would likely result in even longer risk factor disclosure and place additional burdens on issuers preparing such disclosure.

Following the Concept Release and the SEC's request for comments, a number of public company executives, law firms, and other organizations submitted letters of comment. These acknowledged that Regulation S-K contains some duplicative and potentially confusing disclosure requirements, but also expressed concerns about a move too far away from the current principles-based approach to risk factor disclosure.

For example, Chevron vice president and comptroller, Jeanette L. Ourada's July 22, 2016 letter argued that the principles-based approach to risk factors is preferable to a more rules-driven one, because "Each company and its related risk factors are unique…" and "…imposing a forced ranking, numerical limitation, an assessment of probability of occurrence … could lead to more boilerplate and also potentially misleading, disclosures." In his September 30, 2016 letter, the vice president, controller and chief accounting officer of General Motors, Thomas S. Timko, echoed this view, stating "Registrants should not…be required to rate or disclose the probability of occurrence of each risk," and citing concerns ranging from creating an air of "imminent concern" where none may exist to potential stockholder litigation or SEC enforcement proceedings. The executive vice president, general counsel and chief regulatory officer of Nasdaq, Inc., Mr. Edward S. Knight, further noted in his September 16, 2016 letter that "Nasdaq believes that principles-based disclosure grounded in materiality allows reporting companies the degree of flexibility needed to provide investors with the proper amount and mix of information."

Even among law firm commenters, including Sullivan & Cromwell LLP, Davis Polk & Wardwell LLP, and Shearman & Sterling LLP, whose comments were generally more varied with respect to how the SEC might modernize or revise risk factor disclosure requirements, there appears to be consensus that the SEC should leave sufficient room for issuers to characterize and utilize specific risk factors tailored to management's judgement; therefore suggesting support for maintaining the principles-based approach.

Specific Risk Areas

While the market awaits the SEC's final rule-making in connection with the reforms proposed in the Concept Release, certain specific subject areas have come to the forefront of risk factor disclosure in recent years. These include: cybersecurity, climate change, and exposure to international economic and political conditions including the decision by the United Kingdom to leave the European Union (Brexit) and the election of Donald Trump as President of the United States.

Cybersecurity

In October 2011, in response to news reports about the proliferation of companies becoming the targets of cyberattacks, the SEC provided specific guidance relating to risk factors on cybersecurity. This guidance, issued in the form of CF Disclosure Guidance: Topic No. 2, Cybersecurity (October 13, 2011), emphasized the potentially significant risk such cyberattacks might pose to issuers and stated that while "no existing disclosure requirement explicitly refers to cybersecurity risks and cyber incidents, a number of disclosure requirements may impose an obligation on registrants to disclose such risks and incidents." The SEC added that "[i]n addition, material information regarding cybersecurity risks and cyber incidents is required to be disclosed when necessary in order to make other required disclosures, in light of the circumstances under which they are made, not misleading." The SEC's cybersecurity guidance also noted that cybersecurity related disclosure may be required not only in the Risk Factors, but also in the management's discussion and analysis of results of operations and financial condition (MD&A), business, and/or litigation sections of Securities Act and Exchange Act filings.

Registrants should focus on cybersecurity risks that are specific to their respective businesses. For example, rather than including a risk factor in a registration statement or Exchange Act report that merely states that breaches of cybersecurity could have a material adverse effect on an issuer's business, it would be more helpful to investors to describe, without giving away any trade secrets or providing a roadmap to potential hackers, how the particular company would be affected by a breach in cybersecurity. Management should analyze whether there are any special features of an issuer's business that make it more vulnerable to cyberattacks, or that would cause a cyberattack to result in more damage to that issuer than to other companies in the same industry.

In recent years, many companies have chosen to revisit or introduce cybersecurity risk factors due to the high profile security breaches that have taken place at Target, Neiman Marcus, and other companies, as well as the nature of the SEC's remarks in the aftermath of those breaches (including at a cybersecurity roundtable held in March 2014). For example, following the cybersecurity breaches it faced, Target and others included the following risk factor headings in their 2016 10-Ks:

> "If our efforts to protect the security of information about our guests, team members and vendors are unsuccessful, we may face additional costly government enforcement actions and private litigation, and our sales and reputation could suffer." – Target Corp. 10-K (for the fiscal year ended January 30, 2016)
>
> "We face cybersecurity risks and may incur increasing costs in an effort to minimize those risks." – Levi Strauss & Co. 10-K (for the fiscal year ended November 27, 2016)
>
> "We are exposed to risks related to cybersecurity and protection of confidential information." – S&P Global Inc. 10-K (for the fiscal year ended December 31, 2016)

See also Cybersecurity Risk Factor.

Brexit

On June 23, 2016, the United Kingdom voted to leave the European Union, in an action commonly referred to as Brexit. To date, while it is not entirely clear what terms the United Kingdom will seek to negotiate with the European Union or what model for Brexit will be adopted, public companies whose businesses may be impacted by Brexit should consider including risk factor disclosure addressing it. This requires ongoing monitoring and analysis of events in the United Kingdom and the European Union, and the accompanying uncertainties and risks. For example, a company with British operations should consider the following risk categories related to Brexit:

- **Exchange rate.** The day immediately after the Brexit referendum in the United Kingdom, the pound sterling fell by more than 10% against the United States dollar, marking the pound's lowest level in over 30 years. Exchange rate fluctuations among the pound, the dollar, and the Euro could have significant impacts on the business, financial condition, and prospects of companies that are based in or conduct business in the United Kingdom.

- **Economic environment.** Following the Brexit referendum, the United Kingdom's credit rating was downgraded by Standard & Poor's (S&P) and concerns of a looming recession in the British economy began circulating. Companies in the United Kingdom or those that conduct significant business or have operations in the United Kingdom could face substantial slowdowns as a result of a potential recession. A number of companies included risk factors relating to the potential macroeconomic conditions in the United Kingdom in the months and years following the Brexit decision.

- **Legal and regulatory uncertainty.** The full scope and process for implementing Brexit remains unclear. However, companies in the United Kingdom may face substantial regulatory changes in areas such as intellectual property protection, data privacy, and immigration and employment regulation, each of which are currently harmonized, to some degree, with European Union directives. As the United Kingdom withdraws from the European Union, significant regulatory changes in these and other areas may occur with little or no warning as the United Kingdom will no longer be obligated to harmonize its regulatory regime with that of the European Union. Companies will have to respond to this changing regulatory regime and could face substantial costs, both financial and operational, in doing so. This type of risk is heightened for companies that operate in highly regulated industries (e.g., pharmaceuticals, telecommunications, and financial services, among others) and those that rely on United Kingdom and/or European Union regulatory protections.

- **Political uncertainty.** The weeks following the Brexit decision included significant political upheaval in the United Kingdom. The then-prime minister, David Cameron, promptly resigned and was succeeded by the current prime minister, Teresa May. Upon taking office, Ms. May instituted significant changes to the cabinet. As the United Kingdom continues through the Brexit process, further political, social, and economic changes will occur and a certain level of uncertainty will continue. This uncertainty may be exacerbated by the results of the 2017 elections in strong European Union-member states, including France and Germany.

- **Other risks.** In addition to the risks highlighted above, companies with specific operations in the United Kingdom must be cognizant of how and when these and other Brexit risks may be material to their business. For example, companies with significant United Kingdom and/or European Union presence should also consider the impact of the potential loss of the freedom of movement of people, goods, and services and what these changes will mean for the global markets, including, among other things, a potential decline in the number of companies opting to list on the London stock markets.

A number of companies have already started to include Brexit risk factors in their 10-Ks for 2016, and foreign private issuers are likely to follow suit in their upcoming 20-Fs. Examples of these risk factors are as follows:

> "The results of the United Kingdom's referendum on withdrawal from the European Union may have a negative effect on global economic conditions, financial markets and our business." – ConAgra Foods, Inc. 10-K (for the fiscal year ended May 29, 2016)
>
> "The results of the United Kingdom's ("UK") European Union ("EU") membership referendum could adversely affect customer demand, our relationships with customers and suppliers and our business and financial statements." – Air Products and Chemicals, Inc. 10-K (for the fiscal year ended September 30, 2016)
>
> "The U.K. electorate voted in favor of a U.K. exit from the E.U. in a referendum, which could adversely impact our business, results of operations and financial condition." – IHS Markit Ltd. 10-K (for the fiscal year ended November 30, 2016)
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> "The results of the Referendum of the United Kingdom's Membership of the European Union may adversely affect our business and profitability." – Delphi Automotive PLC 10-K (for the fiscal year ended December 31, 2016)

New U.S. President

On January 20, 2017, Donald J. Trump took office as the 45th president of the United States. His first weeks in office have been marked by significant changes that are likely to have substantial impacts on a wide range of social, political, and economic interests. For example, based on statements made during the presidential campaign and actions taken during the first weeks of his presidency, businesses in the healthcare, environmental, and energy sectors may soon see radical new legislation proposed by President Trump that could have a material impact on their businesses.

Despite having been in office only a relatively short period of time, a number of companies have begun including risk factors relating to Mr. Trump's presidency in their SEC filings, highlighting concerns that the change in the administration could adversely impact their companies. In many cases, the concerns arise from comments that Mr. Trump has made regarding his desire to make radical changes to the U.S. import/export policies and tariff structures, the U.S. tax code, and the U.S. federal securities regulatory regime. Such disclosures include:

> "The results of the 2016 United States presidential and congressional elections may create regulatory uncertainty for the alternative energy sector and may materially harm our business, financial condition and operating results." – Workhorse Group Inc. (prospectus supplement dated January 27, 2017)
>
> "If President Trump imposes significant tariffs or other restrictions on foreign imports, our revenues and results of operations may be materially harmed." – Super Micro Computer, Inc. 10-Q (for the quarterly period ended December 31, 2016)
>
> "Any attempt by President-elect Trump to withdraw from or materially modify NAFTA and certain other international trade agreements could adversely affect our business, financial condition and results of operations." – Methode Electronics, Inc. 10-Q (for the quarterly period ended October 29, 2016)
>
> "The results of the 2016 United States presidential and congressional elections may create regulatory uncertainty for the wind energy sector and may materially harm our business, financial condition and results of operations." – TPI Composites, Inc. 10-Q (for the quarterly period ended September 30, 2016)

Companies should carefully analyze the possible effects of executive orders or legislation adopted by the U.S. Congress under the new president on their particular businesses. While such an analysis of new legislation should be undertaken by management on an ongoing basis regardless of the political climate, some of Mr. Trump's sweeping legislative proposals could have a significant effect on a number of sectors of the economy in a relatively short period of time, if adopted into law.

Drafting Tips & Practice Pointers

Beyond the recent developments in risk factors disclosure discussed above, management and counsel must remain cognizant of certain fundamental drafting "best practices" for risk factor disclosure. The following practice pointers are suggested as guidance for counsel and management in drafting risk factor disclosures under the current regulatory scheme:

- **Plain English.** Risk factors should be written in plain English. See the SEC's Plain English Disclosure Release No. 33-7497 (Jan. 28, 1998). You should not use technical terms or jargon typically used by specialists in a particular field. Rather, you should describe such terms in a manner that is understandable to a non-expert in the particular field. The goal is to make the risk factor understandable to investors.

- **Materiality.** Does the risk factor under consideration meet the materiality threshold described above in this article? If management concludes that there is a substantial likelihood that a reasonable investor would consider the potential risk factor important in deciding whether to buy or sell the company's securities, then you should disclose it.

- **Be specific; avoid boilerplate.** Management should focus on the material risks that are relevant to their specific company, and avoid boilerplate and generic risk factor disclosure. While the SEC solicited comments on whether registrants should be required to disclose generic risk factors (such as in a dedicated section of the risk factor disclosure), unless and until the SEC adopts any such new requirement, you should draft succinct descriptions of the risk factors that are the most significant to a particular company.

- **Be concise.** Many companies and their counsel view the risk factor section of their registration statements and Exchange Act reports as protection against potential shareholder suits and use it to satisfy the safe harbor under the PSLRA. As a result, some management and counsel take the view that longer is better. This is not necessarily the case. Item 503(c) of Regulation S-K itself requires concise disclosure. Verbose disclosures do not provide more protection than succinct, tightly drafted descriptions of specific material risks and their potential effect on the registrant.

- **Update, update, update.** In light of the continually changing national and global economic and political landscapes and technological advancements, management should analyze recent events on a regular basis to determine whether their businesses are subject to new risks which are material to investors or whether existing risk factors should be updated or reordered. Risk factor disclosure is required in an issuer's annual 10-K or Annual Report on Form 20-F, and any material changes to that disclosure are required to be reported in the issuer's 10-Qs filed each quarter. Management should carefully review recent events on a quarterly basis, in order to determine whether disclosure of any new risk factors, or material changes to previously disclosed risk factors, are required. See Duty to Disclose and Duty to Update.

Additional Considerations

It is generally recognized that risk factors should be presented in a sequenced format, with the most significant risks being listed first and most prominently. This task becomes especially difficult when very different risk factors are being considered for ranking. For example, how do you compare a risk to the operation of a business with a risk resulting from acceleration of a loan? One way to reduce the impact of this issue is to categorize risks into several sub-categories. Thus, an issuer might disclose separately (i) risks relating to the issuer's business, (ii) risks relating to the issuer's indebtedness, (iii) risks relating to the company's capitalization, and (iv) risks relating to a pending offering. Then, once the categories are specified, it may be easier to implement a ranking system within the sub-categories.

As a separate matter, the SEC frequently takes the position that a particular risk factor disclosure in the risk factor section cannot contain any positive or risk-mitigating statements. This can be extremely difficult to navigate, since real world situations rarely present a clear-cut picture of being all negative or all positive. Indeed, disclosures in general require a balancing of factors that call into question a one-sided approach. In responding to SEC comments, the requirement to eliminate positive statements can become nuanced, especially when the issuer is concerned that an all negative statement does not accurately tell the entire story.

Risk factor disclosure is, in itself, risky. As the world becomes more and more complex, and as litigants become more and more creative, it is unlikely that this reality will change.