

# NASAA RISK DISCLOSURE GUIDELINES

*Adopted September 9, 2001*

## I INTRODUCTION

**A. Background.** The risk factor section of the disclosure document presents two purposes that are often in tension with its use as a selling document. First, risk factors alert the potential investor to all of the material risks involved in the offering that bear on the likelihood of business success and financial return to the investor. Second, risk factors protect the issuer from subsequent claims by investors that they were misled by the information in the disclosure document, either by omission or by affirmative misstatements. These guidelines recognize that many variables affect the determination of when disclosure is adequate in the context of a particular offering. Such variables include, but are not limited to, the nature of the offering and the sophistication of the investor.

**B. Purpose of These Guidelines.** By disseminating a uniform set of the most basic disclosure standards applied by the member jurisdictions of NASAA in reviewing disclosure documents, the reviewing jurisdictions expect to reduce the number and avoid the repetition of deficiency comments issued to applicants. These guidelines attempt to collect and illustrate in a convenient manner, guidelines that in the past have been accessible only by researching securities regulators' laws and regulations, releases, bulletin letters, published no-action positions and industry treatises.

**C. Effect of These Guidelines.** These guidelines are intended to provide informal guidance to the public and are not intended to create a standard of civil liability in favor of any private party against any person as a result of lack of adherence to them. A disclosure document not complying with these guidelines, however, may be denied effectiveness by the administrator.

## II FORMAT AND USE OF RISK FACTORS

**A. The Risk Factors Should Immediately Follow the Cover or the Summary.** Consistent with investor protection, a comprehensive listing of the material risks to the potential investor in the offering should be located at the forefront of the disclosure document upon which an investor will make an investment decision. These guidelines recognize that potential investors often focus on the forepart of the document. When comparing potential investment opportunities, consistency in format of often complex disclosure documents further assists the investor.

**B. The Risk Factor Section is a List Identifying the Material Risks Associated with the Offering.** The risk factor section should not be a comprehensive discussion of the

risks and counterbalancing considerations. Like the summary section, the risk factor section is a summary listing of the material disclosures that are discussed and analyzed in more detail in the appropriate, related sections of the body of the disclosure document. Consistent with this purpose, most risk factors will not be comprehensive discussions of the issues. The risk factor section itself should be limited in length. In order to emphasize the nature of the disclosures as risks, no ameliorative statements should appear in the risk factors.

**C. Prioritize.** The risk factors that identify risks the potential investor is likely to find most significant should appear at or close to the beginning of the list. Burying factors such as the auditors' "going concern", significant recent losses, or 100% dilution in the middle of a lengthy list of risk factors would be inconsistent with these guidelines.

**D. Risk Factor Captions Should Appear in Off-Set Type.** As a listing of the material risks of the potential investment, captions should stand out to the eye of the reader. *Italicized*, **bold-face**, or underlined type assists the reader to quickly comprehend the scope and nature of the particular risk factors, and permits the reader to focus further on the risk factors of most interest to that reader. For the same reason, issuers should avoid lengthy captions.

### III. RISK FACTOR CONTENT

**A. Each Caption Succinctly Identifies the Risky Element of the Factor.** The caption should avoid the use of general, boiler-plate language. For instance, "**Competition**" merely identifies the subject of the risk factor. The alternative, "**Established Retailers Have Recently Entered The Company's Market**", is specifically tailored to the offering, the nature of the competitive risk, and suggests the negative aspect of the risk. As a topic sentence to the factor, the caption can further streamline and shorten the factor.

**B. Specific Cross-References Point the Reader to Complete Discussions of the Issue.** Consistent with principles of "Plain English" disclosure, risk factors should not merely repeat *verbatim* disclosure appearing elsewhere in the disclosure document. Where appropriate, the risk factor should be a two or three sentence summary with a cross reference to the discussion appearing elsewhere in the disclosure document. In some cases, there may be no need to repeat the risk factor in the body of the disclosure document. If a risk factor uses multiple cross-references, the references should not then repeat the same disclosure. These guidelines recognize that potential investors often focus interest on disclosure that is of most interest to them, and cross-references assist the potential investor in locating this disclosure.

**C. Eliminate General, Boiler-Plate Risk Factors.** Include only risks that are material to the particular offering or the particular issuer, and, in narrowly drawn cases, particular to the industry segment. Do not include generic risks such as the absence of past dividends or expectation to pay future dividends by a development-stage company. A generic risk factor that the issuer "faces significant competition from established, well-financed companies with greater resources. . ." is an example of an inappropriate risk factor.

**D. Forward Looking Statements.** Disclosure in the form of boiler-plate legends

frequently appears at the beginning of the risk factor section. As the risk factors constitute the “cautionary language” referred to in the legend, these legends are redundant in the risk factor section. They also detract from a “reader-friendly” introduction to the risk factors, and should be moved to follow the risk factors or to some other section of the disclosure document.

#### **IV. GUIDANCE ON SPECIFIC RISK FACTORS OFTEN APPROPRIATE TO A RISK FACTOR SECTION.**

Issuers must analyze appropriate risk factors for each offering on a case-by-case basis. Moreover, there is no single acceptable way to draft disclosure for a particular risk factor. You may find it helpful to refer to the SEC Staff Legal Bulletin No. 7 (Corporation Finance), dated September 4, 1998, and its June 7, 1999 update, entitled “Plain English Disclosure,” for guidance in writing risk factors. You may also find it helpful to refer to Appendix A of the NASAA Small Company Offering Registration (SCOR) Manual.