ANDORRA

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Law and Practice

Contributed by Cases & Lacambra

Contents

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1. Structured Finance

1.1 Market Overview

The financial landscape of the Principality of Andorra ("Andorra") is constituted by a predominance of banking activity with a few big players (banking entities) which carry out their activities within a universal banking model. Andorra does not have a direct connection to secondary markets and there are neither public offering nor private placement regulations; therefore, capital markets transactions – particularly structured finance – are limited as of the time of writing.

Given the close proximity of Andorra to and its interaction with all the European Union ("EU") Member States, in June 2011 Andorra signed a Monetary Agreement between the EU and Andorra (the "Monetary Agreement"), which came into force on 1 April 2012, by virtue of which Andorra committed to adopt and implement, within certain timeframes, a substantial part of the EU financial legislation (as set down in the Annex to the Monetary Agreement, as amended from time to time). Thus, a notable degree of homogenisation has been achieved between the Andorran and EU financial and banking legal frameworks in a short period of time. However, essential pieces of legislation – including capital markets regulations – are yet to be implemented into the Andorran legal landscape.

Nevertheless, since 2017 there has been an increase in capital markets transactions mainly through cross-border structuring. As one of the main milestones, July 2017 saw the first allocation of pure Andorran risk through a structured covered bonds issuance. The covered bonds were originated and secured by means of a cover pool consisting of prime first-ranking residential mortgage loans granted to Andorran residents by a local banking entity.

The main trends in Andorran capital markets and structured finance could be summarised as follows: (a) the progressive opening up of Andorra to international capital markets along with an enhanced interest of local players in diversifying their financing sources; (b) progressive implementation of key pieces of EU banking and financial legislation during 2019 and 2020 (Regulation (EU) No 648/2012 of the

European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories ("EMIR"), Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments ("MiFID II") and Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments ("MiFIR") as well as Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms ("CRD IV")); and (c) ongoing legislative initiatives (unified code regulating financial activity in Andorra and modern insolvency legislation) which could enhance the local capital markets legislation.

2. Acquisition Finance/Leveraged Finance

2.1 Transaction Structure, Players and Legal Regime

Acquisition finance/leveraged finance transactions are rare in Andorra due both to their own nature (ie involving the lending of extremely large amounts of capital) and to the limited size of local banking entities and their conservative lending policy (usually involving solid guarantee schemes that provide a high level of collateralisation).

It is usual to obtain financing from overseas banking entities to fund acquisitions of large Andorran targeted investments (either on a standalone basis or through syndicated lending) by foreign entities. In these cases, the financing is granted outside Andorra and the guarantees are located within Andorra.

There are no specific laws or regulations governing acquisition finance/leveraged finance transactions currently in force in Andorra. The legal framework is composed of generic pieces of legislation which establish a de minimiscorpus through programmatic principles and overall ratios for bank lending (a capital adequacy ratio of 10% and a liquidity ratio of 40%).

No particular trends in respect of the finance parties, sponsors or target industries for acquisition/leveraged finance are currently observed in the Andorran financial sector.

2.2 Documentation

Acquisition finance/leveraged finance transactions are typically documented through contractual schemes in which two main components may be distinguished: (a) financing document set; and (b) guarantee schemes document set. Frequently, the financing documentation is governed by Andorran or foreign law (Spanish or English law), whereas the guarantee schemes are governed under Andorran law if the assets are located in Andorra (eg pledged shares of a local company or its premises over which a mortgage is granted) or when personal guarantees are issued by local entities/companies (eg banking guarantees).

Please note that the choice of a foreign law as the governing law of an agreement is valid and legally binding under Andorran laws. Such foreign law may be applied by an Andorran court as long as it is proved in court to be in compliance with the applicable procedural rules (ie by the party invoking such foreign law supplying proof of its content and validity) without contravening the Andorran public order provisions.

2.3 Security

Due to the risk intrinsically involved in acquisition finance/leveraged finance transactions, comprehensive security packages are typically used. Although the structure of a security package may substantially vary depending on the specific characteristics of the transaction (and primarily on its risk level), the following security scheme would normally be seen in these sorts of transactions: (a) security granted by any special-purpose vehicles (SPVs) incorporated to receive the debt and equity investment as well as guarantees over such SPVs' shares (eg pledges); and (b) security granted over the target company in favour of the lenders as well as any of its subsidiary companies (eg pledge over shares, first demand bank guarantees, comfort letters).

This standard security package scheme would commonly be complemented by a battery of tailored representations and warranties and covenants in favour of the lenders/sponsors. If the target company is integrated within a group structure, it would normally be required that the subsidiaries grant cross-guarantees depending on their relative weight percentage in the group structure measured by specific indicators (eg assets held or earnings perceived).

There are no specific legal or practical restrictions or limitations as to the sort of assets that may be used as security. However, please note that under the current state of the law there is not a direct enforcement civil procedure (ie prior declarative civil proceeding must be carried out and a judgment needs to be obtained as a prior step for its subsequent enforcement) enshrined by Andorran rules of civil procedure.

In general, a distinction may be made between: (a) creation of security interests; and (b) creation of mortgages. In the first case, the intervention of a notary public and its raising into the status of public deed are only required when such a security interest is to have effects against third parties; in the case of mortgages, their creation requires two consecutive steps, the granting of a public deed before a notary public and its registration (which has a constitutive effect for the mortgage).

Pursuant to this requirement and due to the absence of a Land Registry – whose equivalent body is the Chamber of Notaries of the Principality of Andorra (" *Cambra de Notaris del Principat d'Andorra* "), which acts as a central register for the custody of public deeds' protocols – the registration requirement is fulfilled by means of a marginal note made by the same notary who raises the mortgage into the status of public deed.

Security enforcement procedures available under Andorran laws are: (a) judicial proceedings; and (b) notarial proceedings. Specifically, the judicial enforcement proceeding requires bringing a prior declarative civil proceeding and obtaining a judgment as a prior step for the subsequent enforcement of such judgment, which makes it more costly and time-consuming. On the other hand, the notarial enforcement proceeding is more time-efficient but requires both parties' commitment to undertake it.

2.4 Restrictions and Limitations

Under Andorran laws, thin-capitalisation requirements determine that own resources of banking entities shall not descend beneath the level stated for minimum own resources (ie own funds required to achieve a 10% solvency ratio).

The financial assistance rules provided by capital companies' regulations (ie private and public limited companies incorporated under the laws of Andorra) do not apply to Andorran financial entities when entering into credit operations with third parties. If financing is granted to financial entities within the group of the lender entity (ie banking entity), financial assistance rules limit the granting of assistance to a maximum generic percentage of 10% of the lender entity's shares. In this respect, it is mandatory to make an accounting reserve on the liabilities' balance sheet equivalent to the value of the shares accepted as guarantee.

Corporate benefit rules are also applicable in connection with acquisition finance/leveraged finance transactions. Specifically, operative entities of the Andorran financial system authorised to operate by the Andorran regulator (Andorran National Finance Institute – " *Institut Nacional Andorrà de Finances* ", INAF) must enact solid corporate governance procedures, including a suitable organisational structure proportionate to the nature, scale and complexity of their activity, to the risks to which they are exposed and to the nature and typology of the services they provide. Such organisational structure must be clear, with well-defined, transparent and coherent lines of responsibility, as well as effective procedures for the identification, management, control and reporting of risks to which the entity is or may be exposed.

Namely, the board of directors of banking entities defines the risk level that the entity is willing to assume and approves the respective risk management policies, periodically supervises their compliance and adopts suitable measures to correct any deficiency under corporate benefit rules (ie its actions must benefit the entity's interest as a whole, acting diligently and faithfully towards the entity in compliance with applicable standards – the diligence of an organised businessman and loyal representative – and avoiding competing with and taking advantage of the entity as well as using its assets to pursue personal purposes).

2.5 Lender Liability

There are no particular lender-liability issues to be considered in Andorra other than the lending reservation of activity regime. In this respect, all financial activities carried out within Andorra must be exclusively performed by operating entities authorised to operate by the INAF by means of an administrative procedure (common to all operating entities). Particularly, only banking entities may carry out lending activities (ie receiving deposits or other reimbursable funds; granting loans and credits, including, in particular, consumer credit, mortgage credit, factoring with or without recourse and financing of commercial transactions – including forfaiting – as well as financial leasing and non-financial leasing with or without purchase option).

Therefore, only banking entities incorporated under the laws of Andorra may grant acquisition finance and carry out local leveraged finance transactions. If a foreign entity (ie non-INAF-authorised entity) is deemed to have granted acquisition finance and carried out leveraged finance transactions within Andorra, criminal sanctions (ie imprisonment and economic fine up to EUR150,000) would be triggered.

2.6 Debt Purchase Transactions and Debt Trading

A borrower or financial sponsor may not directly engage in debt purchase transactions when this is carried out in a manner deemed to be a financial activity under Andorran laws.

During the last quarter of 2017 a portfolio of performing loans along with shares of an insurance brokerage entity was traded between local banking entities. Due to constraints arising from bank secrecy and personal data protection regulations in place in Andorra, debt portfolios are normally traded on a face-to-face basis between local banking entities. In the case of mortgage debt trading, it is also usual that the original lender entity (ie seller) enters into a servicing agreement with the debt-purchaser entity in order to continue managing cash-flows arising from the mortgages and the diverse relations with the mortgages' borrowers.

2.7 Certain Funds Concept

Granting of funds by a lender to a borrower on a certain-funds basis is not typically seen in Andorra.

2.8 Financial Restructuring

There have been no significant financial restructurings in Andorra since the partial implementation of Act 8/2015,

of April 2nd, on urgent measures to implement restructuring and resolution mechanisms of banking institutions " *Llei 8/2015, del 2 d'abril, de mesures urgents per implantar mecanismes de reestructuració i resolució d'entitats bancàries* " ("Act 8/2015"). This piece of legislation largely mirrors the provisions of Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms ("BRRD").

In addition to the fact that the local financial restructuring and resolution regulations have only been tested once in a financial turmoil scenario, the main challenges for a successful financial restructuring from both a legal and financial perspective are: (a) difficulties for the affected entity's board of directors in setting up a viable restructuring plan which allows the injection of fresh money, mainly due to the limited size of the Andorran financial market; (b) in connection with the previous point, the lack of access to a lender of last resort (due to the fact that Andorra is not integrated within the EU); and (c) the configuration of the restructuring conditions within the applicable regulations; in this light, an entity is considered to be in a restructuring situation (i) when it is in breach of, or (ii) when there are factual elements on whose grounds it is reasonably foreseeable that the entity will be in breach of, the solvency and discipline regulations within the short term; thus, unless the local regulator immediately detects these liquidity tensions and acts ex officio or the affected entity immediately communicates such circumstance, the difficulty of obtaining fresh money notably hinders reversal of the financial turmoil situation due to the limited access to liquidity.

2.9 Reform

As of the time of writing, there are no pending legislative reforms in Andorra that will directly impact on acquisition finance/leveraged finance transactions.

However, it is worth pointing out that the total implementation of BRRD has not yet been completed and that on 6 June 2018 the Andorran Government introduced a draft bill on solvency, liquidity and prudential supervision for banking entities and investment firms. Such draft bill has been already published (although its entry into force is expected before 2019) and its content to be aligned with CRD IV and Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms ("CRR"), in line with the requirements of the latest Annex to the Monetary Agreement.

3. Securitised Debt

3.1 General

There are no specific laws or regulations governing securitisation transactions and/or the transfer and sale of assets in connection with securitisation transactions. In these scenarios, the transfer/sale of any assets would follow the general legal regime for sale and transfer of assets.

Notwithstanding the above, Act 8/2015 provides a reference for the legal regime for securitisation transactions from the bail-in sequence perspective.

Under Andorran laws the transfer of ownership requires the concurrence of two elements: (a) a valid transfer of title (ie an agreement adequate to perform the outright transfer of ownership of the subject of the agreement); and (b) the delivery (*traditio*) of the subject of the agreement from the seller to the purchaser.

Please note that securitisation transactions are not frequent in Andorra and we are not aware of any taking place as of the time of writing. There has nonetheless been several plans to carry out pass-through and synthetic securitisations involving mortgaged real estate assets by local banking entities.

We expect real estate securitisation transactions involving real estate credit receivables to be seen in the short to mid term, regardless of any other receivables being used in these sorts of transactions.

No "skin in the game" requirements or similar risk-retention requirements are applicable for originators of securitised debt under Andorran laws due to the absence of express regulation.

In our view, the normal scenario would be for securitisations to be governed under English law and, therefore, the risk-retention requirements stated in CRR would apply (ie a material risk-retention requirement of 5%).

3.2 Asset Transfer

Transfer of receivables is legally achieved by means of (a) assignment, (b) assumption of the contract (ie creditor's modification) and (c) inter alia, sale, swap or donation of the receivables. Please note that under Andorran laws the assignment of receivables is a generic legal process which entails the transfer of credit rights over the receivables and, although normally carried out as a sale agreement, it may vest in other contractual forms (as long as the credit right over the receivables against a third party is effectively transferred from one contractual party – the assignor – to the other – the assignee – with a valid contractual purpose).

Overall, the transfer of receivables does not require any particular formalities to be valid and effective. However,

if the transfer of receivables includes the transfer of those receivables' guarantees (mortgage-backed receivables), this will require the assignment agreement to be raised into the status of public deed.

It is not mandatory to notify the sale/transfer of receivables to the underlying creditors at the time of the sale/transfer of the receivables, but this is recommended. However, please note that underlying debtors will be entitled to exercise a set-off right against the amounts due to the transferor/assignor of the receivables until the notification of the sale/transfer to the transferee/assignee.

No specific requirements or obstacles are applicable in relation to the sale and transfer of receivables subject to the Andorran consumer legislation.

Please note that the banking consumer relationship must be at all times held with a local financial entity.

There are specific requirements/obstacles in relation to the sale and transfer of receivables under the Andorran data protection legislation and banking secrecy. Particularly, if the sale and transfer of receivables entails the transmission of personal data of third parties, such data shall not be transferred outside the perimeter of the Andorran financial system (ie transferred to an entity located outside Andorra which does not have data-processing facilities in Andorra).

In case of transmission of personal information of third parties (eg borrowers in a mortgage assignment or transfer) to an entity alien to the Andorran financial system, a servicing agreement with a local entity (ie banking entity) to treat and manage third parties' personal data would be a viable pathway to avoid violation of the Andorran data protection legislation.

It is worth mentioning that the recent entry into force of Regulation (EU) No 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data could, due to its extraterritorial scope of application, impact on transfer of personal data (Article 3).

Deferred purchase price or price-adjustment clauses are typically observed in this sort of transaction.

Under Andorran laws there is no specific definition nor are there specific requirements to be fulfilled for a sale of receivables in the context of a securitisation transaction to qualify as a "true sale". Nevertheless and subject to a case-by-case analysis (among others, in the case of automatic repurchases), in our view it is reasonably foreseeable that the sale of receivables would qualify as a "true sale" in the manner provided for in CRR by means of a generic sale agreement which allows the transfer of the receivables out of the assignor's balance sheet.

3.3 Issuance Vehicle

Please note that due to the absence of regulations governing capital markets and equity and debt issuances in Andorra, local SPVs are not frequently incorporated herein but in tax-efficient overseas jurisdictions, in which local banking entities already have authorised debt issuance programmes in place and established subsidiaries (eg Republic of Ireland and The Netherlands).

Structures involving an offshore SPV for a structured covered bonds issuance to ring-fence the insolvency risk have extended. As far as we are aware, no offshore trusts for issuance structures have been incorporated.

There are no minimum capitalisation requirements for a local SPV other than the minimum capitalisation requirements for incorporating private and public limited companies under Andorran laws, which range from a minimum share capital of EUR3,000 (private limited companies) to EUR60,000 (public limited companies).

Please note that the vast majority of local and overseas SPVs are incorporated as private limited companies and that the incorporation of an overseas SPV by a locally licensed entity (banking entity) is subject to prior authorisation by and registering before the INAF under Act 8/2013, of May 9th, which covers the organisational requirements and operating conditions of entities operating in the Andorran financial system, investor protection, market abuse and financial securities agreements " *Llei 8/2013, del 9 de maig, sobre els requisits organitzatius i les condicions de funcionament de les entitats operatives del sistema financer, la protecció de l'inversor, l'abús de mercat i els acords de garantia financera* ".

Desirable aspects of overseas SPVs include: (a) appointment of independent directors; (b) imposing specific restrictions embedded in its by-laws; (c) limiting its tax presence to a sole country; (d) entering into an outsource corporate services agreement with an entity in order to provide governance, financial and tax services to the SPV (eg appointment of directors and submission of annual financial accounts and statements).

All in all, the goal is to limit the SPV's activity to carrying out strictly the functions required for the specific issuance.

Andorran laws do not provide for the possibility of incorporating multi-issuance vehicles/compartment companies for issuing purposes.

In the scenario of a bankrupted Andorran-law SPV vesting in the form of a private or public limited company, Andorran generic insolvency laws do not provide for the possibility of

consolidation of the SPV's assets with those of the originator, as the legal regime does not draw a distinction between principal and secondary insolvency proceedings.

Concerning the scenario of insolvency of the originator, the specific restructuring and resolution legal regime for banking entities stated in Act 8/2015 does not expressly provide for the consolidation of the SPV's assets with those of the originator, but expressly invests the Andorran Resolution Agency (*"Agència Estatal de Resolució d'Entitats Bancàries* ", AREB) with the following powers: (a) amortisation and conversion faculties over equity instruments of the originator or the SPV; and (b) inclusion of the SPV's liabilities eligible for the bail-in sequence held between the SPV and the originator.

It is worth noting that although the consolidation of assets of the SPV with those of the originator is not expressly determined in the specific restructuring and resolution legal regime for banking entities, the AREB is granted with extraordinary powers which, in practice, could have effects similar to the consolidation of assets (eg determining the instruments into which the resolution is concreted such as, among others, any structural modifications – eg merger of the SPV with the originator) although their adoption is not foreseeable.

3.4 Bankruptcy Remoteness

An issuance vehicle may be incorporated overseas as a bankruptcy-remote entity by an originator for the purposes of a securitisation transaction (ie the originator being an Andorra banking entity). In such a scenario, (a) the issuance vehicle must be incorporated in and under the laws of a specific overseas jurisdiction, (b) prior authorisation by the INAF for the issuance vehicle's incorporation (or for the purchase of an already existent vehicle) must be obtained by the originator and (c) the debt ceiling for the issuance of securitised debt must also be prior authorised by the INAF.

In the scenario of insolvency of the originator there is a risk that the sale and transfer of assets may be set aside under the claw-back regime. Specifically, under the Insolvency Decree dated 4 October 1969 " *Decret en relació a la cessació de pagaments i fallides, del 4 d'octubre de 1969* ", in the scenario of the originator's insolvency declaration (" *cessació de pagaments* "), the Andorran competent judge (" *batlle* ") is entitled – by petition of the insolvency administrators appointed upon the declaration of insolvency – to set aside any sorts of transactions which are found to be prejudicial to the originator's insolvency estate which have been carried out by the originator within the 24 months prior to the initiation of its insolvency procedure (i) falling into any of the following categories: (a) transactions formalised through agreements where the originator's obligations largely exceed those of the other contractual party; (b) all prepayments of non-matured debts that are verified; or (c) all mortgages or guarantees granted over assets of the insolvent entity after the date of cessation of payments for securing pre-existing debts of the insolvent entity; or (ii) being gratuitous acts carried out until a maximum of six months prior to the date of cessation of payments.

Please note that depending on the specific characteristics of the issued securitised debt, such liabilities may fall into the scope of the bail-in tool provided for in Act 8/2015, whose implementation into the Andorran legal framework, although largely based on Article 44.2 BRRD, still presents certain particular differences pursuant to the legal regime of the bail-in sequence (internal recapitalisation sequence of the insolvent financial entities).

3.5 Reform

Please note that the implementation of Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation is not currently envisaged in the latest Annex to the Monetary Agreement.

As stated above, please bear in mind that in early June this year, the Andorran Government introduced a draft bill on solvency, liquidity and prudential supervision for banking entities and investment firms.

4. Other Asset-based Lending

4.1 Factoring

There are no laws or regulations governing the transfer and sale of assets in connection with a factoring transaction under the laws of Andorra, which only provide for its qualification under generic lending activities, which include – besides the granting of loans and credits (consumer credit and mortgage credit) – factoring with or without recourse and financing of commercial transactions (including forfaiting).

In its status as an activity subject to the reservation of activity regime, factoring transactions can only be carried out within Andorra by local banking entities.

Please note that due to the generic regulation of factoring transactions as stated above and due to the absence of specific regulations on this matter, factoring transactions must be analysed on a case-by-case basis.

Nevertheless, factoring transactions carried out in Andorra largely follow the main features of factoring transactions performed in the EU.

Transfer of receivables is legally achieved by means of (a) assignment, (b) assumption of the contract (ie creditor's

modification) and (c) inter alia, sale, swap or donation of the receivables.

Please note that, under Andorran laws, the assignment of receivables is a generic legal process which entails the transfer of credit rights over the receivables and, although normally carried out as a sale agreement, it may vest in other contractual forms (ie as long as the credit right over the receivables against a third party is effectively transferred from one contractual party – the assignor – to the other – the assignee – with a valid contractual purpose).

Overall, the transfer of receivables does not require any particular formalities to be valid and effective. However, if the transfer of receivables includes the transfer of those receivables' guarantees (mortgage-backed receivables), this will require the assignment agreement to be raised into the status of public deed.

The sale/transfer of receivables does not require to be notified to the underlying creditors at the time of the sale/transfer of the receivables, but this is a recommended action.

In our view, and despite the absence of specific laws or regulations stating the consideration of the sale of receivables for purposes of a factoring transaction as a "true sale", this transaction would qualify as such (especially in the case of specific factoring modalities such as advance non-recourse factoring).

As of the time of writing there are no pending reforms envisaged which will impact on the existing or create a new legal regime governing factoring transactions in Andorra.

4.2 Covered Bonds

As of the time of writing there is no specific legislation for statutory covered bonds in Andorra nor a harmonised framework in the EU in force. However, as of 12 March 2018, a proposal for a directive on covered bonds was issued by the European Commission (COM (2018)) (94 final 2018/0043 (COD)). This proposal lays down the common conditions that covered bonds must fulfil throughout all Member States to be recognised under EU law.

This proposal is aimed at establishing a homogeneous regulation and sets out: (a) specific statutory covered bonds' structural essential elements (ie double recourse mechanism, segregation, transparency, composition requirements and governing body of the cover pool, hedging requirements, liquidity and ratio requirements as well as immunity to insolvency procedures – no acceleration); (b) the possibility of establishing an equivalence regime for covered bonds issued out of the EU within three years from the date on which Member States are obliged to apply the dispositions for the directive's transposition; and (c) that EU banks may issue covered bonds backed by a cover pool consisting of assets located outside the EU, as long as such assets comply with the cover pool eligibility criteria and grant investors an enforcement regime analogous to equivalent assets located in the EU.

Such legislative proposal also strengthens investor protection by imposing specific supervisory duties and is complemented by a proposal for a regulation amending CRR. These proposals are part of the Capital Markets Union (CMU) action plan and are conceived as an important step forward to enhance capital markets' integration in the EU.

The only covered bonds transaction carried out so far in Andorra was carried out during September 2016 and the last quarter of 2017. Specifically, it was an English and Andorran law governed structured (contractual) covered bonds issuance for a first EUR100 million tranche rated BBB+ by Fitch Ratings listed in the Irish Global Exchange Market (GEM). The issuance was carried out under the umbrella of a Euro Medium Term Notes (EMTN) and Covered Bonds Programme of a Dutch subsidiary fully owned by a local banking entity authorised by the INAF to issue debt with a EUR500 million ceiling.

The main features of this issuance were: (a) the covered bonds were originated and secured by means of a cover pool consisting of prime first-ranking residential mortgage loans granted to Andorran residents; (b) the cover pool was transferred by means of a mortgage sale agreement governed by Andorran law to an Irish designated activity company (DAC) acting as a bankruptcy-remote SPV to ring-fence the insolvency risk; (c) obligations of the issuer (local banking entity) versus the covered bondholders were secured through dual recourse against the Irish SPV and the Andorran banking entity; (d) to enhance covered bondholders' protection beyond the dual recourse, the Andorran banking entity granted an ad hoc Andorran financial collateral (pledge) in favour of the covered bondholders to exclude the covered bonds from the bail-in sequence in a hypothetical insolvency scenario of the issuer.

The assets comprising the cover pool in the above-mentioned covered bonds issuance were prime first-ranking residential mortgage loans granted to Andorran residents which fulfilled, inter alia, the following eligibility criteria: (a) each mortgage loan was originated in the normal course of the issuer's business and was a fully-disbursed non-revolving euro-denominated mortgage loan; (b) no mortgage loan presented a current balance exceeding EUR2 million; (c) all mortgage loans were backed by first-ranking mortgages; (d) their maturity limit was December 2060; (e) no mortgage loan was more than 30 days in arrears at the time of the cover pool transfer; (f) the loan-to-value rate did not exceed 100% for any mortgage loan; and (g) all mortgages were granted over properties located in Andorra.

In the context of this transaction, investors were contractually granted and benefited from a direct and privileged claim over the cover pool in the event of the issuer's default. Expressly, in this transaction the double recourse mechanism was upgraded by means of the granting of the ad hocfinancial guarantee referred to above.

Desirable aspects of overseas SPVs include: (a) appointment of independent directors; (b) imposing specific restrictions embedded in its by-laws; (c) limiting its tax residence to a sole country; and (d) entering into an outsource corporate services agreement with an entity in order to provide governance, financial and tax services to the SPV (eg appointing adequate directors, submitting annual financial accounts and statements).

All in all, the objective is to limit the SPV's activity to carrying out strictly the functions required for the specific issuance.

Act 8/2015 does not expressly provide for the recourse of the investors to the cover pool in the event of the insolvency of the issuer to be excluded from the bail-in sequence as in the manner stated in Article 44.2 BRRD.

Nevertheless, we are of the opinion that this piece of legislation should not substantially deviate from the ratio legis of BRRD.

Total implementation of BRRD is still expected to be completed. It remains to be seen whether this will affect covered bonds transactions, although the implementation of European legislation into the Andorran legal framework has traditionally been performed in a conservative manner.

Moreover, the implementation of CRD IV/CRR capital adequacy requirements is foreseen to be applicable from 1 January 2019, although a draft bill on solvency, liquidity and prudential supervision for banking entities and investment firms has already been introduced by the Andorran Government.

Thus, covered bonds exposure will receive the treatment currently provided for in CRR upon its implementation, without prejudice to the potential (a) adoption and transposition of the covered bonds directive proposal referred to above into the Member States' legislation and (b) its future implementation within the Andorran legal framework via an update to the Annex to the Monetary Agreement.

4.3 Other Secured Bonds

The only covered bonds transaction carried out so far in Andorra has seen credit rights of the issuer pledged in favour of the investors. Please note that bond issuances are not frequent in Andorra due to the absence of capital markets legislation.

5. Credit-linked Notes

5.1 Main Structures

The most common type of structured products being issued in Andorra is credit-linked certificates/notes (CLNs) exclusively addressed to professional investors with particular characteristics/structures. We have seen domestic CLN issuances under hybrid formats (prospectus/programme) addressed to professional investors which are normally clients of the issuer and hold opened banking/custody accounts with the issuer, with restrictions upon transferability and negotiability outside Andorra.

In such issuances, (a) such CLNs were characterised as fixed and/or floating interest rate financial complex instruments with a high degree of risk under Andorran laws; (b) no authorisation was required from the INAF; (c) they were configured as non-negotiable and not freely transferable illiquid financial instruments denominated in euros or US dollars (with a EUR100,000 minimum denomination); (d) they represented mere contractual claims against the issuer (local banking entity) and were not subject to specific maturity terms; (e) their existence was linked to the existence of a banking relationship issuer-investor; (f) they were issued and entered into by investors in Andorra and details of the issuance were kept in the record books of the issuer.

Please note that there are no regulations on prospectuses for public offerings currently in force in Andorra.

5.2 Parties Acting as Protection Seller/Issuer/Investors

Protection sellers are normally overseas banking entities, yet local banking entities also have adopted such role as well as an issuer (protection purchaser) role.

Investors usually are Andorran residents (classified as professional clients under Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments ("MiFID I") and MiFID II framework), although foreign institutional investors may also invest in locally-issued CLNs.

5.3 Structures Involving Issuances via an SPV and/or a Trust

Structures involving issuances through overseas SPVs and/or trusts are not frequent in Andorra. As stated above, bespoke CLN issuances (which are even carried out as on-demand issuances) are the typical issuance format for CLNs in Andorra though, in any case, these sorts of issuances are not frequent due to the limited size of the Andorran financial market.

5.4 Reference Portfolios

Generally, reference portfolios/parameters to determine credit events (ie predetermined event such as a bankruptcy

whose occurrence triggers modifications for the payment structure of the CLNs by, inter alia, cancelling or reducing the fixed or floating interest payment) encompass different scenarios (eg failure to pay obligations when due, financial restructuring, filing for bankruptcy, governmental intervention) related to overseas corporate entities located in different geographical areas (eg European, US, Asian or Latin American as well as sovereign entities).

5.5 CLN Transactions

CLN transactions do not allow issuers (normally local banking entities) to reduce risk-weighted assets in relation to loans extended by them.

5.6 Privately Placed or Publicly Offered CLNs

Customarily the placement is privately driven irrespectively of the specific tranching of the CLNs as there is no public offering or private placement regime under the current state of the law.

5.7 Main Transparency Requirements

Under Andorran laws, generic transparency requirements applicable to issuance of financial instruments apply to CLN issuances due to the absence of specific legislation.

In this light, CLN issuances are subject to the generic transparency requirements provided for in Act 8/2013, of May 9th, which covers the organisational requirements and operating conditions of entities operating in the Andorran financial system, investor protection, market abuse and financial securities agreements (in essence, documentation of the issuance in writing clearly stating the rights and obligations of both the issuer and the investor; making available such written document reflecting CLN issuance characteristics, normally in the registered office of the issuer in Andorra; informing promptly the investors of any relevant incidents concerning their investment(s); and establishing effective and transparent procedures which allow a reasonable and agile treatment of investors' or potential investors' claims and registering such claims in an adequate and durable format).

Additionally, local conduct of business rules provided by INAF Technical Communication 163/05, 23 February 2006 " *Comunicat núm. 163/05 Ref. Normes ètiques i de conducta* " in respect of rules for ethics and behaviour must be observed. Broadly speaking, such rules entail that: (a) advertising must be in accordance with the principles of truth and objectivity and not be misleading; (b) advertising for services available to consumers must provide enough information about the services' main characteristics; (c) advertising materials must not go against the dignity of individuals or constitutional rights/values; and (d) advertising materials must not be disloyal (ie to create unfair competition).

Lastly, specific INAF Technical Communications on structured products have been issued in past years. Specifically, in 2012, INAF Technical Communication No 222/12 on structured products " *Comunicat núm. 222/12 Productes estructurats* " was issued establishing disclosure obligations on the local banking entities towards the INAF on different aspects of structured products commercialised during 2012.

5.8 Pending Reform

As of the time of writing there are no pending reforms which will impact/create a legal regime specifically governing CLN issuances or establishing a prospectus regulation or a private placement regime. However, it is worth noting the forthcoming implementation of the MiFID II and MiFIR framework, which as per the latest Annex to the Monetary Agreement is provided for by the end of 2020 (31 December 2020).

6. Structured Products – Notes, Warrants and Certificates

6.1 General

One of the most common type of structured products being issued in Andorra is credit linked certificates/notes exclusively addressed to professional investors with ad hoc characteristics.

Local players do not issue structured products (ie notes, warrants and certificates) on a large-scale and regular basis due to the limited size of the Andorran financial market.

Nonetheless, we are lately seeing a rise in the issuance of structured deposits addressed to professional clients (principal and non-principal at risk) with different underlyings (predominantly, equities, funds and funds' baskets).

Local banking entities are active in issuing structured products in Andorra (usually as bespoke or on-demand transactions addressed to professional investors). On the other hand, overseas banking entities are also active in this segment by offering structured products to local banking entities for their distribution into Andorra, usually by entering into distribution agreements (in the case of long-term established commercial relationships) or through mere execution letters (normally when the commercial relationship tends to be more intermittent).

Please note that in these scenarios the overseas banking entity will distribute structured products exclusively to the local banking entity, which will on-sell such products to investors (normally their own clients). Thus, no direct commercialisation from the overseas banking entities towards end-clients within Andorra takes place so as not to breach the reservation of activity regime, as this would entail imposition of criminal sanctions under the Andorran Criminal Code.

6.2 Legal and Regulatory Regime

All financial activities carried out and financial services rendered within Andorra are subject to obtaining prior authorisation from the INAF. This reservation of activity regime also encompasses marketing activities for financial activities or services.

Due to the limited size of the Andorran financial sector and although no express legal exemptions are provided for by Andorran laws, the INAF allows foreign financial entities to sell products directly or render services on a cross-border basis (ie from outside Andorra) exclusively to locally licensed entities (normally banking entities) without triggering licensing, registration or authorisation requirements (ie without breach of the reservation of activity regime).

The issuance and offering of structured products within Andorra may therefore only be carried out by locally licensed entities (banking entities, financial investment companies and financial investment agencies) authorised by the INAF in accordance with the specific administrative procedure provided for by Act 35/2010, of June 3rd, on the authorisation regime for the creation of new operating entities " *Llei 35/2010, del 3 de juny, de règim d'autorització per a la creació de noves entitats operatives del sistema financer andorrà* ".

Please note that there is no specific legislation governing the issuance and offering of structured products in Andorra. This activity is governed by a generic programmatic legislation aimed at establishing minimum requirements regarding the financial activity structure and investor protection.

Generic authorisation from the INAF obtained through the administrative procedure provided by Act 35/2010, of June 3rd, on the authorisation regime for the creation of new operating entities is required for locally licensed entities to sell structured products to retail and professional investors in Andorra.

There are no legal or regulatory restrictions on the issuance of structured products in Andorra.

As regards the offering of structured products in Andorra, their commercialisation must comply with the commercialisation requirements stated in Act 8/2013, of May 9th, which covers the organisational requirements and operating conditions of entities operating in the Andorran financial system, investor protection, market abuse and financial securities agreements (whose standards are aligned with the MiFID I framework) and with the local conduct of business rules provided for in INAF Technical Communication No 163/05 23 February 2006 on rules for ethics and behaviour.

The INAF, in its capacity as financial regulatory body, is granted wide-ranging intervention powers towards financial activity under Act 10/2013, of May 23rd, on the Andorran National Institute of Finance " *Llei 10/2013, del 23 de maig, de l'Institut Nacional Andorrà de Finances* ". Please note that under the current state of the law, product-intervention powers expressly regulated under MiFID II (article 69(1)(s)) are not expressly determined under Andorran laws (especially, suspension of the marketing or sale of financial instruments or structured deposits where specific conditions under Regulation (EU) No 600/2014 are met, as well as suspension of the marketing or sale of financial instruments or structured deposits, where the specific investment firm has not developed or applied an effective product approval process or otherwise failed to comply with organisational requirements established in article 16(3) MiFID II).

Although not expressly granted specific product-intervention measures, the INAF continuously monitors structured product activity. For instance, in 2012 the INAF demanded that the local banking entities disclose the totality of structured products commercialised until 11 January 2012 through the INAF Technical Communication 222/12 referred to above. Specifically, the Andorran regulator ordered disclosure of: (a) all existing structured products, making a distinction between own products and products issued with the local banking entity acting as intermediary; (b) ISIN; (c) guaranteed or non-guaranteed character; (d) maturity; (e) existence of credit event(s); (f) issuance amount (in euros) stating reference currency; (g) invested amount (in euros) by the clients, distinguishing between managed and non-managed clients as well as the specific number of clients; (h) invested amount by the banking entity itself; and (i) aggregate levied fees' amount (2011 period).

6.3 Documentation

The issuance/offering of structured products is normally documented by means of agreement(s) along with a purchase order, yet this typical documentation set varies depending on the specific financial entity. The agreement(s) offered to the investors must comply with requirements stated in Act 8/2013, of May 9th, which covers the organisational requirements and operating conditions of entities operating in the Andorran financial system, investor protection, market abuse and financial securities agreements.

6.4 Distribution

Due to the limited size of the Andorran financial market and the scarce demand for structured products, local banking entities normally enter into commercial relations with large overseas banks (usually large investment banks) in order to be supplied with structured and complex financial products. Although not expressly required by law (due to the absence of an express legal framework), distribution agreements for structured products entered into between overseas investment banking entities and local banking entities are common for the distribution of structured products within Andorra.

Such distribution agreements (or mere execution letters when a relationship is developed on a more intermittent basis) regulate the relationship between the distributor (foreign bank) and the acquirer (local banking entity), through which the acquirer purchases financial products from the distributor to subsequently on-sell them to its own clients (often Andorran residents categorised as professional clients). Likewise, entering into a master distribution agreement (MDA) is a viable course of action.

There is no uniform content of such distribution agreements, whose provisions may vary on a transaction-by-transaction basis. Nonetheless, certain key provisions are regularly observed: (a) the local banking entity should represent that (i) it is acting as principal and is distributing the financial products in accordance with all applicable laws and regulations; (ii) that it is the only responsible party to the distribution of the financial products and that it will carry out the distribution in compliance with MiFID investor protection rules; and (iii) that it is familiar with all laws, regulations and restrictions applicable to any distribution of financial products in Andorra and that it has complied, and will comply, with all such laws, regulations, restrictions and conditions; (b) it is recommended to clearly determine whether marketing materials will be provided by the foreign bank to the local distributor; (c) the foreign entity should double-check with the local distributor the content of the advertising materials to be provided to the end-users in order to verify that the local entity complies with the contractual provisions of the distribution agreement; and (d) consideration provisions.

Essentially, the duties of the distributor (foreign entity) are to provide the acquirer (local entity) with the products or render the services as agreed in the distribution agreement and, residually, comply with any other obligations contractually provided for in good faith.

Please note that no express legal duties are imposed on the distributor as a result of the absence of legal regulation regarding financial product distribution agreements.

Distributors (foreign entities) are compensated by the issuer for their distribution activities. We normally see independent entities integrated within the same group acting as issuer and distributor.

6.5 Listing and Trading Distribution

There are no exchanges/secondary market infrastructures in Andorra. Thus, structured products are, in any case, listed and traded on exchanges outside Andorra.

6.6 Prospectus Liability, Regulatory and Criminal Sanctions

Please note that there are no specific prospectus regulations in place in Andorra. The liability regime lies in generic provisions regulating the marketing, offer and sale of financial instruments to investors.

The potential sanctions scenario for locally licensed entities (normally banking entities) which market and sell structured products in breach of the applicable Andorran laws and regulations may include (a) imposition of criminal sanctions (eg fraud); (b) imposition of administrative sanctions; (c) risk of the resulting agreements being held to be unenforceable; and (d) risk for the individuals (ie directors or employees of the local entity) who knowingly participated in the offence.

6.7 Reform and Trends

As of the time of writing the main pending reforms that will impact on the issuance and offering of structured products in Andorra are the upcoming implementation of the MiFID II and MiFIR framework, which as per the latest Annex to the Monetary Agreement is foreseen by the end of 2020 (31 December 2020).

7. OTC Derivatives

7.1 Regulatory Restrictions

Entering into OTC derivatives transactions by local counterparties (normally local banking entities) does not require obtaining any prior licence or approval.

Under Act 10/2008, of June 12th, on Andorran law collective investment undertakings, Andorran law collective investment schemes (investment funds) incorporated as collective investment schemes in transferable securities (" *Organismes d'Inversió Colectiva en Valors Mobiliaris* ", OICVM as per its Catalan term), which are similar to European UCITS regulated under Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities, are subject to restrictions pursuant to entering into OTC derivatives.

Overall, OICVM's investment policy must guarantee an adequate risk-sharing and liquidity level. In relation to investments in derivatives (including OTC derivatives), OICVM are free to invest in such financial instruments as long as: (a) the underlying asset is a financial instrument, a financial index, interest rate, exchange rate or currency exchange in which the OICVM may invest in pursuit of the investment objectives stated in the OICVM's constitutional documents; (b) its counterparties are entities subject to prudential supervision and correspond to the categories stated in the OICVM's constitutional documents; and (c) OTC derivatives are subject to a daily reliable and verifiable valuation which can be sold, liquidated or settled at any time at its fair value by means of an offsetting operation. In any other

cases, OICVM are subject to restrictions for investing in OTC derivatives.

Furthermore, OICVM management entities must apply procedures which allow a precise and independent assessment of the OTC derivative instruments to be carried out. OICVM management entities must at all times ensure that the level of global risk associated with OTC derivatives does not exceed the total net value of the OICVM portfolio. In this connection, OICVM may invest in OTC derivatives which comply with the requirements highlighted in the previous paragraph respecting the following risk diversification requirements: (a) the risk exposure of the OICVM against a counterparty may not exceed 10% of its assets (if the counterparty is a banking entity domiciled in an EU or OECD member state or in Andorra) or 5% in any other case; and (b) the risk exposure resulting from OTC derivatives transactions with a single counterparty may not exceed 20% of its assets. OICVM management entities must put in place management systems which allow for a daily valuation of agreements, an area-specific risk analysis and a breakdown of the investment strategies applied.

Under Andorran administrative regulations, public authorities – including public sector bodies in charge of intervening in the management of public debt and public sector bodies authorised to hold accounts for customers – are also subject to specific restrictions upon entering into OTC derivatives transactions (to the best of our knowledge, "public authorities" refers to the public sector generally considered). In respect of sovereign entities (ie public authorities which exercise public powers attributed by law such as, among others, the Andorran Government and local councils), financial transactions entered into by the government need to be prior authorised by the Andorran Parliament (" *Consell General* ") through the approval of the annual budgetary law, the extraordinary credit laws or the supplementary credit laws. Financial transactions entered into by the local councils (" *Comuns* ") must be authorised by the Plenary of the Council through the approval of the annual budget ordinance, the extraordinary credit ordinances or the supplementary credit ordinance, and specific restrictions on the amount of credit transactions are applicable.

7.2 Standardised Master Agreements/Security Agreements

There are no standardised master agreements/security agreements governed by the laws of Andorra for OTC derivatives transactions (other than ISDA, GMSLA and GMRA), although some banking entities have drafted specific Andorran-law master agreements for documentation purposes with local counterparts.

Typically, standardised master agreements/security agreements governed by English law are predominantly ISDA (1992 and 2002 version), GMSLA (2010 version) and GMRA (2000 and 2011). These standardised agreements are extensively used in the framework of OTC operations normally entered into by local banking entities and overseas banks.

Only a very small fraction of OTC derivatives operations are documented through other such agreements (eg outstanding Overseas Securities Lending Agreement (OSLA) or 1995 GMRA).

Legal opinions as to the validity and enforceability of the aforementioned agreements are normally requested by foreign entities and legal practitioners.

In essence, material conclusions stated in such legal opinions are: (a) that standardised master agreements (ISDA, GMRA and GMSLA) qualify as both a master netting and a financial collateral agreement under the laws of Andorra; and (b) that close-out netting provisions are valid and enforceable from an Andorran legal standpoint. Material qualifications relate to, among others: (a) absence of conflict rules provided by the laws of Andorra; (b) special status of public domain assets of public authorities (which are inalienable, do not prescribe and are not subject to attachment); (c) the enforcement of obligations arising from standardised master agreements may be limited by the provisions of Andorran principles of public policy; (d) there is no specific Andorran case law in respect of the validity and enforceability of master netting agreements; (e) Andorran courts may refuse to uphold the termination of a master netting agreement based on the breach of obligations, undertakings or covenants or change in circumstances that are merely accessory or complementary to the main undertakings, or based on an unreasonable, inequitable or bad faith interpretation of one of the events of default or change in circumstances; and (f) the illegality or invalidity of an essential provision of a master netting agreement (or an essential provision of a master netting agreement becoming unenforceable) may affect the legality, validity or enforceability of its remaining provisions.

7.3 Netting and Close-out Provisions

Netting and close-out provisions set forth in the 1992 ISDA Master Agreement and the 2002 ISDA Master Agreement are enforceable under Andorran laws. Specifically, the legal regime provided for by Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements has been implemented into the Andorran legal framework with no amendments through Chapter V of Act 8/2013, of May 9th, which covers the organisational requirements and operating conditions of entities operating in the Andorran financial system, investor protection, market abuse and financial securities agreements.

Election of automatic early termination is not required and not recommended for ISDA, GMRA and GMSLA governing OTC operations.

Currently there is no country opinion for Andorra on the enforceability of netting and close-out netting provisions. Legal opinions are issued on demand – normally upon petition by foreign banks – and prior to entering into derivatives transactions with local counterparties (local banking entities).

7.4 Stay Acknowledgment

As of the time of writing, there are no specific regulations in force requiring the inclusion of contractual acknowledgment of stay powers of any regulator/governmental body in Andorra, although Act 8/2015 provides for the contractual recognition of the bail-in sequence (in case liabilities of the affected entity are not mandatorily excluded from the bail-in sequence and are regulated by a third-country legislation, the agreements formalised by the relevant entity shall include a submission clause expressly affecting such liabilities to, overall, the exercise of the AREB's powers – amortisation, conversion, reduction of amounts and cancellation faculties).

However, this may be an upcoming legislative requirement, in line with the legislation of other jurisdictions, which fundamentally state that the specific supervised entities must, when entering into new agreements or amending existing agreements, insert a resolution stay clause into such contracts recognising the application of their supervisory bodies' resolution stay powers, if such contracts are governed by a third-country law and establish the jurisdiction of courts other than the courts of the affected entity's home country.

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This legislative trend has crystallised in several protocols issued by the International Swaps and Derivatives Association "ISDA" (ISDA 2015 Universal Resolution Stay Protocol, ISDA Resolution Stay Jurisdictional Modular Protocol as well as for specific jurisdictions such as the United States, the United Kingdom and Switzerland) allowing counterparties to comply with such requirements.

Under Act 8/2015, the AREB is granted extensive administrative and commercial powers over the affected entity's activity. In contrast with BRRD, this Act applies exclusively to banking entities (and not to investment firms).

The AREB may stay certain contractual rights through administrative act (specifically, any payment or delivery obligation arising from any agreement entered into by the affected banking entity) for a period which, at a maximum, can extend from the date on which the exercise of such stay right is published until midnight of the following business day.

Events under which contractual rights may be subject to the temporary stay period are: (i) any payment or delivery obligation arising under any contract entered into by the relevant banking entity and due in the temporary stay period; (ii) the enforcement of any guarantee constituted on any asset of the relevant banking entity during the temporary stay period; and (iii) the right to declare the maturity, early termination, resolution or termination of an agreement entered into by a counterparty with the relevant banking entity (eg ISDA Master Agreement) before the specified temporary stay period finishes.

The AREB is also granted the power to prevent or limit the enforcement of guarantees granted over any assets of the affected banking entity.