BANKING REGULATION

Andorra

LEXOLOGY
Getting The Deal Through

Consulting editor
Debevoise & Plimpton

Banking Regulation

Consulting editors

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Quick reference guide enabling side-by-side comparison of local insights, including into the legal and regulatory framework; supervision and enforcement; resolution; capital requirements; ownership restrictions and implications; changes in control; and recent trends.

Generated 17 March 2023

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UPDATE AND TRENDS

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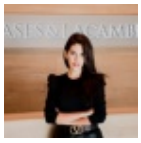

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REGULATORY FRAMEWORK

Key policies

What are the principal governmental and regulatory policies that govern the banking sector?

The main focus of Andorran banking regulation is centred on the stability and efficiency of banks and other Andorran financial entities that operate in the financial system to enhance the confidence of international financial markets in the Andorran banking sector, and to protect the interests of its clients and investors.

Andorran banking regulations are based on the cornerstone principle of reserve of activity. According to this principle, only the banks that have been duly authorised by the local regulator – the Andorran Financial Authority (AFA) – may carry out typical banking activities such as receiving deposits and other funds from clients, and granting any kind of credits by its own account. Andorran banks can also render investment and ancillary services.

Andorran banking regulation is being increasingly influenced by international standards in financial regulation (ie, European and international financial standards), which are taken as a reference by the Andorran legislature to adapt its internal banking regulation. Andorra signed the Monetary Agreement with the European Union in 2011, which, on occasion, obliged the Andorran government to implement several financial, banking and anti-money laundering European directives and regulations.

The latest Annex to the Monetary Agreement (published on 14 July 2022) foresees the forthcoming implementation of the following key pieces of legislation into the Andorran legal framework between 2023 and 2024:

- Directive No. 2014/65/EU on markets in financial instruments and Directive (EU) No. 2016/1034 of the European Parliament and of the European Council of 23 June 2016 amending Directive No. 2014/65/EU on markets in financial instruments (MiFID II);
- Regulation (EU) No. 600/2014 on markets in financial instruments (MiFIR);
- Directive (EU) No. 2019/879 of the European Parliament and of the European Council of 20 May 2019 amending Directive 2014/59/EU (BRRD) as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms, and Directive 98/26/EC;
- Directive (EU) No. 2019/2034 of the European Parliament and of the European Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU (CRD IV) and 2014/65/EU, and the BRRD;
- Regulation (EU) No. 2019/2033 of the European Parliament and of the European Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No. 1093/2010, (EU) No. 575/2013 (CRR), (EU) No. 600/2014 and (EU) No. 806/2014;
- Regulation (EU) No. 2019/834 of the European Parliament and of the European Council of 20 May 2019 amending Regulation (EU) No. 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, reporting requirements, risk mitigation techniques for OTC derivative contracts not cleared by a central counterparty, the registration and supervision of trade repositories, and the requirements for trade repositories;
- Regulation (EU) No. 2019/876 of the European Parliament and of the European Council of 20 May 2019 amending the CRR as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No. 648/2012; and
- Directive (EU) No. 2019/2177 of the European Parliament and of the European Council of 18 December 2019 amending Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), Directive 2014/65/EU on markets in financial instruments, and Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing.

Law stated - 31 December 2022

Regulated institutions

What are the defining characteristics of a bank to be caught by the banking laws and regulations? Is non-bank fintech regulated differently?

Banking entities are the only entities of the Andorran financial system authorised to receive deposits and other reimbursable funds from the public.

The non-bank fintech sector is still at a very preliminary stage and, therefore, Andorra has not set up a complete regulatory regime applicable to these entities.

Nevertheless, the government of Andorra is officially promoting the use of pioneering and disruptive technologies. In July 2020, the government of Andorra announced the 'Horitzó 23', which is a plan adjusted to the new scenario arising from the health crisis caused by the covid-19 pandemic to promote Andorra's sustainability and digital economy. Andorran banking institutions will be able to benefit from this new and predominantly digital landscape in terms of the collaboration agreements signed with new players such as fintech institutions to reduce costs and offer more complex services to end investors.

Following this committment, Act No. 42/2022 on Digital Economy, Entrepreneurship and Innovation was published in the Official Gazette on 22 December 2022. This piece of law provides for the need to diversify the Andorran economy, and the desire to offer a secure and predictable legal framework in which local and foreign investors can place their trust. In other words, this is a regulation that covers a wide range of questions related to the spectrum of issues linked to the promotion of the digital economy, support for entrepreneurship and boosting innovation.

Law stated - 31 December 2022

Do the rules vary depending on the size or complexity of the banking institution?

There are no specific rules according to the size or complexity of the banking institution. However, the AFA can apply the proportionality principle when carrying out its supervisory functions.

Law stated - 31 December 2022

Primary and secondary legislation

Summarise the primary statutes and regulations that govern the banking industry.

Overall, the primary statutes that govern the banking sector are:

- Act No. 7/2013, dated 9 May 2013, on the regime for the operating entities in the Andorran financial system and other provisions that govern financial services in Andorra; and
- Act No. 8/2013, dated 9 May 2013, which covers the organisational requirements and operating conditions of entities operating in the Andorran financial system, as well as investor protection, market abuse and financial securities agreements.

Act No. 7/2013 establishes the substantive regime for banking and financial activity within Andorra, while Act No. 8/2013 determines the formal aspects (ie, organisational requirements and operating conditions) for Andorran financial entities, jointly with market abuse regulation and the regime of financial collateral arrangements in line with

the corresponding EU regulations. It is worth noting that CRD IV and CRR provisions on prudential, solvency and liquidity have also been implemented to the Andorran regulatory framework.

Specifically, the following rules govern specific areas of the banking sector, including:

- Act No. 35/2018, dated 20 December 2018, on solvency, liquidity and prudential supervision of banking entities and investment firms;
- the act of the financial system disciplinary, dated 27 November 1997;
- Act No. 10/2008, dated 12 June 2008, regulating Andorran collective investment scheme undertakings;
- Act No. 35/2010, dated 3 June 2010, on the legal regime for authorising the creation of new operating entities within the Andorran financial system;
- Act No. 10/2013, dated 23 May 2013, of the Andorran National Finance Institute, as amended by Act No. 12/2018 dated 31 May 2018;
- Act No. 7/2021, dated 29 April 2021, on recovery and resolution of banking entities and investment entities;
- Act No. 12/2017, dated 22 June 2017, on insurance companies and organisations, and supervision of insurance and reinsurance;
- Act No. 14/2017, dated 22 June 2017, on prevention and the fight against money or securities laundering and terrorism financing;
- Act No. 20/2018, dated 13 September 2018, regulating the Andorran Deposit Guarantee Fund and Andorran investment compensation schemes; and
- Act No. 8/2018, dated 17 May 2018, on payment services and electronic money institutions.

Additionally, the AFA is empowered to issue technical communications and recommendations to develop the Andorran banking regulations and apply international standards to the banking industry.

Note that the Accounting Plan of the Andorran Financial System was abolished with legal force from 1 January 2017 by means of the Decree dated 22 December 2016, which transposed the International Financial Reporting Standards (IFRS) rules adopted by the European Union into the Andorran legal framework. Andorran financial institutions apply the IFRS rules to their financial statements.

Law stated - 31 December 2022

Regulatory authorities

Which regulatory authorities are primarily responsible for overseeing banks?

The AFA is the sole supervisor of the Andorran financial system, acting as the macro-surveillance entity responsible for the Andorran banking and insurance sector (there are no stock exchange markets in Andorra). The AFA has been a member of the International Organization of Securities Commissions since 2013. Owing to the enactment of Act No. 12/2017, the AFA also assumed supervision over Andorran insurance and reinsurance entities.

Law stated - 31 December 2022

Government deposit insurance

Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Through Act No. 1/2011, dated 2 February 2011 (related to the creation of a banking entities deposit guarantee system), the Andorran government created a banking deposits guarantee system without legal personality managed by a management committee, which is in turn directed by the AFA. All banks authorised to operate within Andorra participate in the banking deposits guarantee system, funding it through periodic contributions.

Additionally, Andorra has taken clear legislative steps to improve the reliability and soundness of this system. Namely, Act No. 20/2018 continues to establish the maximum amount of coverage at €100,000 per depositor and €100,000 per investor. Furthermore, additional coverage is incorporated in exceptional cases that guarantee a limit of €300,000. The overall limit is €200 million (as absolute value), which shall be increased as the system of annual contributions to the fund assets reaches 1.5 per cent of the calculation basis of contributions. The scope of the protection provided by the banking deposits guarantee system encompasses all cash and securities deposits of natural and legal persons, irrespective of their nationality or domicile, held in local banks.

The banking deposits guarantee system is excluded from contribution to bail-in in the event of bank resolution. Generally, this deposit guarantee system is configured as an ex post mechanism by paying the corresponding amounts secured in the case of intervention or resolution of an Andorran bank.

To date, the deposits guarantee system has never been applied to the financial assistance of Andorran banks. Moreover, the Andorran State Agency for the Resolution of Banking Institutions and the Andorran Fund for the Resolution of Banking Institutions, as the financing mechanism for the banking resolution processes, were incorporated in 2015, pursuant to Act No. 8/2015 and amended by Act No. 7/2021, fully transposing the BRRD.

Law stated - 31 December 2022

Transactions between affiliates

Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

The legal regime on transactions that banks may carry out with their affiliates is basically made up of Act No. 35/2018, dated 20 December 2018, as Andorran banks that act as a group have to comply with solvency and liquidity ratios and risk concentration limits stated in this act under a consolidated basis.

Under Andorran law, an affiliate relationship applies when there is one dominant and one dependent entity, and the dominant entity directly or indirectly:

- holds the majority of the voting rights of the dependent entity;
- has the power to appoint or to remove the majority of the board of directors of the dependent entity;
- has appointed exclusively with its votes at least the majority of the board of directors of the dependent entity; or
- exercises control of the board of directors of the dependent entity where at least the majority of its members are directly or indirectly directors of the dominant entity.

The type of entity and its specific regulatory status are the criteria that determine the activities that Andorran financial entities may carry out. Banks may perform the widest spectrum of activities, as these are the only entities authorised to take deposits or other repayable funds from the public. Additionally, banks are also authorised to render investment services and investment ancillary services, yet they can neither directly manage collective investment schemes nor perform the activities reserved to life insurance companies unless they acquire either a majority or a minority stake in these companies.

In relation to the other Andorran financial entities that act in the Andorran financial system, the essential note is that they have a limited range of activities and services. For example, investment financial entities may render both investment and ancillary services as well as complementary activities provided that their principal activity continues to be performed efficiently. On the other hand, they cannot carry out typical banking activities. Non-banking financial entities of specialised credit (specialised credit institutions) may only grant financing under any form (eg, mortgage loans) and manage entities of collective investment schemes.

All the aforementioned financial institutions have an exclusive corporate purpose. Therefore, they may only render the relevant financial services established by law with express exclusion of other activities, except for complementary activities that are reasonably linked to their financial business.

Law stated - 31 December 2022

Regulatory challenges

What are the principal regulatory challenges facing the banking industry?

The Andorran legislator has made significant efforts in recent years to adapt and modernise the Andorran banking industry to meet international standards.

In this regard, areas such as investor protection, market abuse regulation, the general regulatory regime for Andorran financial entities and regulation of financial guarantees have been set up and strengthened, as well as the regulation for banking resolution and restructuring.

Nevertheless, there are several upcoming challenges that must be carefully monitored for their impact.

Insurance and reinsurance regulation

Act No. 12/2017 on regulation and supervision of insurances and reinsurances in Andorra serves as a cornerstone for the Andorran insurance market. In particular, the main challenges are the adaptation of Andorran insurance entities to the capital requirements imposed by this act, which are aligned with the provisions of Solvency II, as well as the exercise of effective and efficient supervision by the AFA. Act No. 12/2018 provides the AFA with all the necessary authority, powers and instruments to exercise as the sole supervisor of financial and insurance industries in Andorra.

Banking industry framework

One of the main challenges for the banking industry is to continue to open up to foreign investment and, at the same time, to maintain its independence and remain a competitive financial hub by implementing the commitments agreed upon in the Monetary Agreement. Furthermore, the Andorran government signed an agreement with the European Union in February 2016 that involved the incorporation of the Andorran legal framework to the Organisation for Economic Co-operation and Development's Common Reporting Standard. This commitment came into force by the enactment of Act No. 19/2016 of 30 November 2016 on the automatic exchange of tax information.

Bank resolution and restructuring regulation

The main challenges in this matter refer both to the modernisation of the Insolvency Decree, dated 4 October 1969, which governs the general bankruptcy regime, and its alignment with Act No. 7/2021, which provides for the specific banking insolvency regime, and the level of effectiveness and certainty that their combination has to provide.

Association agreement

Currently, the Andorran government is working on the future framework of relations between Andorra and the European Union to allow progressive and structured access to the EU internal market, taking into account the particularities of Andorra by means of a specific association agreement.

Digital transformation and technological innovation

Andorra has recently invested significant amounts of money in digital projects to improve the entities' technological basis. Therefore, the Andorran banking industry is facing a crucial transformation as they are beginning to update their services to become more sophisticated in response to investors' needs. As such, the recently implemented Act No. 42/2022 on Digital Economy, Entrepreneurship and Innovation shall boost digital transformation and technological innovation in the banking industry.

Law stated - 31 December 2022

Consumer protection

Are banks subject to consumer protection rules?

Andorran banks are subject to general and specific consumer protection rules.

The general consumer protection rules are established by Act No. 13/2013, dated 13 June, on effective competition and consumer protection. Its key points may be summarised as follows.

General principles on consumer protection

The good faith principle, fair equilibrium between consumer protection and competitiveness of companies as well as the irrevocable status character of consumer protection regulation are the keystones of this regulation.

Basic rights of consumers

In addition to any applicable provisions established by sectoral rules and civil regulation, the basic rights of consumers that are protected are health and safety; economic and social interests; and the right to information.

Requirements common to all consumer relations

The following requirements must be met at all times:

- consumer relations may not cause a risk to health, insurance or environment, unless expressly permitted by law;
- publicity, information and offers made by any means may be subject to the principles of veracity and objectivity, and must not lead to confusion or error;
- availability of information to consumers by businesses;
- availability of information regarding beneficial conditions for consumers;
- requirements and configuration of the right of withdrawal;
- requirements and configuration of the guarantee over products and post-sale service;
- customer satisfaction and product suitability;
- seller's responsibility;

- civil liability for damage caused to consumers;
- abusive clauses;
- special modalities for sale; and
- information and diffusion on consumption through mass media.

Unfair terms

Act No. 13/2013 provides a general definition of unfair terms and a catalogue of possible contractual clauses with consumers that may be considered unfair and, therefore, void. Unfair terms are defined as all those that derive from an agreement that have not been individually negotiated and all practices not expressly permitted that, against the good faith principle obligation, cause prejudice to a consumer and a material imbalance between the rights and obligations of each party to a contract.

Specific protection rules apply to Andorran banks in respect of investment services under Act No. 8/2013, which is in line with the provisions of Directive 2004/39/EC on markets in financial instruments. This aims to maintain and enhance certain ethical and behavioural principles as well as regulate specific practices that are actively combatted internationally.

The AFA is the Andorran authority responsible for the enforcement of consumer and investor protection rules.

According to Act No. 8/2013, a retail investor or client is any individual or legal person other than a professional investor or client. In turn, professional investors are clients that possesses the experience, knowledge and expertise to make their own investment decisions and to properly assess the risk that they incur.

The Commerce and Consumer Unit is the administrative body responsible for the development, promotion and implementation of policies with the aim of improving the Andorran commercial sector, as well as for protecting consumers' rights.

In addition, the implementation of MiFID II and MiFIR is planned for 2023.

Law stated - 31 December 2022

Future changes

In what ways do you anticipate the legal and regulatory policy changing over the next few years?

The main trends regarding legal and regulatory policy will be in accordance with the commitments contained in the Monetary Agreement (eg, money laundering, capital requirements, payment services, electronic money and financial instruments market regulations). The Andorran government is working to enact a gradual and comprehensive framework of securities law. Moreover, Andorra is currently negotiating jointly with Monaco and San Marino for an association agreement with the European Union. The main objectives of this association agreement are the participation of Andorra, Monaco and San Marino and their citizens in the European single market, and to give the possibility to European investors and banking entities to enter these jurisdictions. However, Andorran economic and financial needs alone would accelerate the implementation of international standards to operate on a level playing field.

Law stated - 31 December 2022

SUPERVISION

Extent of oversight

How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

The Andorran Financial Authority (AFA) is the regulatory authority for Andorran banking entities, which performs a supervisory role over Andorran financial entities, in accordance with Act No. 10/2013. Since Andorra is not a member of the European Union, the AFA is not integrated within the framework of the Single Supervisory Mechanism.

The main objectives of the AFA are:

- to promote and ensure the proper functioning of the Andorran financial system;
- to ensure the stability and reputation of the Andorran financial system and contribute to reducing systemic risk deriving from credit events affecting the Andorran financial entities or their counterparties;
- to provide adequate protection to clients and investors;
- to enhance the competitiveness of Andorra as an international financial hub;
- to reduce the systemic risk that derives from the financial markets;
- to perform all activities that may be deemed necessary for the exercise of its functions; and
- to regulate the Andorran insurance and reinsurance sector.

Supervision performed by the AFA has as an essential aim to protect the public interest rather than to guarantee the individual interests of the supervised entities or the interest of their clients and third parties. It performs supervision on a consolidated basis over entities operating in the Andorran financial system, Andorran undertakings of collective investment schemes, financial markets located or operating in Andorra or requiring authorisation by the AFA to operate, and those natural or legal persons over whom the AFA may exercise supervisory powers.

The most relevant functions and competences of the AFA that Act No. 10/2013 does expressly foresee, among others, are:

- to issue technical communications, and communications and recommendations to develop the regulation and instrumental technical regulations in accordance with Andorran law and also with international standards;
- to supervise, on a consolidated basis, groups of entities that operate in the financial system;
- to exercise disciplinary and sanctioning power;
- to examine and manage the claims brought against Andorran banks before it and, possibly, carrying out specific controls if the problem advertised through the claim regards prudential supervision;
- to undertake services of treasury for the state and manage the issuance of public debt; and
- to assess the Andorran government on economic and financial policy.

The AFA has discretionary powers to conduct investigations and on-site inspections over Andorran banks, and to request information from supervised entities. The AFA can also impose administrative penalties in the case of a breach of the obligations imposed by the Andorran financial legislation. These on-site inspections carried out by the AFA are frequent and conducted in a thorough manner.

In spite of not being an EU member state, article 20 of Act No. 10/2013 foresees the international cooperation with other regulators, in addition to the AFA condition as a member of the International Organization of Securities Commissions (IOSCO). In this regard, there is a memorandum of understanding (MoU) in force between Andorra and Spain, signed on 4 April 2011, which does the following:

- constitutes an agreement for consolidated cooperation in the supervisory framework between the AFA and the

Bank of Spain;

- establishes the terms of the protocol for the relationship and collaboration between both authorities; and
- enables the supervisory authority of the country of origin to request information of consolidated risks of banking groups from the relevant authority of the country where the entity has subsidiaries.

In addition to this MoU, the AFA signed the Multilateral Memorandum of Understanding on cooperation and exchange of information on 17 September 2013, becoming a member of the IOSCO framework.

Law stated - 31 December 2022

Enforcement

How do the regulatory authorities enforce banking laws and regulations?

Banking regulation is enforced by the AFA, which is entitled to exercise the widest enforcement powers.

The AFA's enforcement powers include, among others:

- restricting or limiting the bank's business and operations;
- requesting divestment of activities that pose excessive risks;
- requiring institutions to limit variable remuneration;
- requesting the use of net profits to strengthen own funds;
- imposing specific liquidity requirements; and
- requesting judicial assistance to undertake its powers.

Law stated - 31 December 2022

What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

In recent years, the principal enforcement issues with relevant implications for the banking sector have been:

- the increase in the default ratio (NPL ratio) of the Andorran banks;
- compliance with the anti-money laundering act; and
- the judicial proceedings issued against unfair terms incorporated in consumer contracts.

Nevertheless, the volume and intensity of these enforcement issues have been significantly lower than in other jurisdictions (eg, promotions of preferred shares to retail investors).

Law stated - 31 December 2022

RESOLUTION

Government takeovers

In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

Act No. 7/2021 comprises a set of rules specifically applicable to the restructuring and resolution of banks, in line with the provisions stated in Directive 2014/59/EU on establishing a framework for the recovery and resolution of credit institutions and investment firms.

Under this law, banks may be taken over by the regulatory authorities (the Andorran Financial Authority (AFA) or the Andorran State Agency for the Resolution of Banking Institutions (AREB)) when they infringe – or it is expected that they will infringe in the near future – insolvency, organisational or disciplinary regulations.

Once a bank is in one of such situations, the AFA can adopt several measures to rectify them. If the situation cannot be rectified, the AFA will have to determine whether the bank is unviable.

If the AFA determines the unviability of the bank, it must communicate that situation to the AREB, which will decide which resolution measures to implement.

Bank intervention and processes of resolution and restructuring are governed by the following principles:

- shareholders will necessarily bear losses in the first place;
- after the shareholders, creditors will bear losses pursuant to the seniority of their credits;
- there will be an equivalent treatment for creditors with same seniority;
- shareholders and creditors will not bear higher losses than those that would have arisen under an insolvency proceeding;
- the directors may be replaced and shall be responsible for any damage caused to the bank; and
- full protection to guaranteed deposits is provided.

The AREB may intervene in a credit institution's business to start its restructuring and, possibly, its resolution process if:

- there is evidence that the bank's situation may damage its stability, liquidity and solvency;
- in a restructuring, the AREB may order the removal or replacement of one or several members of the bank board of directors, as well as senior management members, if it determines that such members are not eligible to fulfil their obligations in accordance with the mandatory aptitude requirements; or
- right after the opening of a resolution process, the AREB shall dictate the substitution of the whole board of directors – this measure has a limited temporal extent of one year, although it may be extended by the AREB to the extent necessary for the smooth development of the resolution process.

Law stated - 31 December 2022

Bank failure

What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

The role of the bank's management and directors in the framework of a bank failure can be explained by distinguishing the following plans: the action plan (living will); the debt restructuring plan; and the reorganisation of activities plan.

Under Act No. 7/2021, the bank's management must draft an action plan where the bank is already, or is foreseeably going to, enter an insolvency situation. The objective of the plan is to provide measures to restore the bank position and must be accompanied by a specific implementation schedule.

In addition, the board of directors must draft a plan to negotiate debt restructuring with a part or the totality of creditors.

Furthermore, in the event of internal recapitalisation being used as resolution instrument, the AREB will ask the board of directors to draft a plan for the reorganisation of activities. This plan shall contain measures that, in accordance with

the economic situation of the bank and the markets in which it operates, are geared towards re-establishing the long-term economic viability of the entity, either in the totality of its activity or a part of it, within a reasonable period of time. This plan must be approved by the AREB, prior to a non-binding consultation with the AFA. The AREB shall also adopt all necessary measures to ensure the fulfilment of the reorganisation plan.

Law stated - 31 December 2022

Are managers or directors personally liable in the case of a bank failure?

Managers or directors may incur personal liability in the event of a bank failure. Such liability may be civil, criminal or administrative, or a combination thereof.

Civil liability implies that the directors may be liable for any damages caused if a causal link between the bank failure and their acting with gross negligence or wilful misconduct is verified.

Criminal liability exists in several cases (eg, false accounting, negligent management of the business and fraudulent transactions prior to commencement of the restructuring process).

From an administrative perspective, infringements are classified in different grades: very serious, serious and minor. The sanctions that may be imposed on the managers or directors in the case of a bank failure and depending on the gravity of the sanction are:

- pecuniary sanctions (from €36,000 to €200,000), which may be imposed on directors in the event of, among other things, obstructing the functions of the AREB and the AFA with respect to analysis of the bank's situation;
- removal from the position of director and disqualification from exercising management or direction activities in the failed entity for five years;
- disqualification from exercising management or direction activities in any financial or banking entity and removal, as the case may be, from his or her position as director, for a period less than 10 years;
- an order for the directors to cease and desist from the prejudicial activity performed against the entity; and
- public reprimand in the Andorran official journal or the website of the sanctioning organisation or private reprimand.

Law stated - 31 December 2022

Planning exercises

Describe any resolution planning or similar exercises that banks are required to conduct.

Under Act No. 7/2021, the bank's management must draft an action plan where the bank is already, or is foreseeably going to, enter an insolvency situation. The objective of the plan is to provide measures to restore the bank position and must be accompanied by a specific implementation schedule. This plan would include the different actions foreseen under the plan with the necessary information to conduct them, for example:

- detailed information on the strategy considered to address the circumstances;
- a description of the arrangements to ensure operational continuity of the business; and
- a description of the financing requirements and financing sources necessary for the implementation of the strategy foreseen in the plan.

Law stated - 31 December 2022

CAPITAL REQUIREMENTS

Capital adequacy

Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

On 20 December 2018, the General Council approved Act No. 35/2018 (the Capital Adequacy and Solvency Law) on solvency, liquidity and prudential supervision of banking entities and investment firms. On 6 March 2019, the General Council approved the corresponding regulation, which both implement Directive 2013/36/EU (CRD IV) and Regulation (EU) No. 575/2013 (CRR) in Andorra.

Andorran banks are subject to the minimum capital adequacy, solvency and liquidity ratios, as well as prudential supervision. The minimum percentage of own resources that banking entities have to maintain at all times is the level of own funds necessary to reach a solvency ratio of 10 per cent. For the liquidity ratio, the minimum is 100 per cent.

Without prejudice to the obligations derived from the solvency and liquidity ratio, Andorran banks shall have solid, effective and exhaustive strategies and procedures to evaluate and permanently maintain the amount, type and distribution of share capital that is adequate to cover the nature and the level of risk to which the bank may be exposed. These strategies and procedures must be periodically subject to evaluation. Moreover, Andorran banks must have a minimum share capital of €5 million.

Additionally, to fulfil these obligations, Andorran banking entities must maintain a reserve to fulfil the covered guarantees, and an amount equivalent to this reserve must be invested in secure and liquid assets that fulfil a series of requirements established by law for this purpose.

The regulatory capital and liquidity requirements derive from the application of Basel III provisions.

Law stated - 31 December 2022

How are the capital adequacy guidelines enforced?

Banks are required to report information quarterly to the AFA in relation to solvency and liquidity ratios. The communication will be made during the first 15 days following the date of submission of the correspondent quarterly balances. Additionally, the AFA is entitled to demand that banks declare their ratio situation at any moment it deems it necessary.

On the basis of such information, the AFA will be able to determine whether a bank is undercapitalised, in which case it will step in.

Law stated - 31 December 2022

Undercapitalisation

What happens in the event that a bank becomes undercapitalised?

Banks that do not comply with the solvency and liquidity ratios are normally required by the AFA to draft a restructuring plan. This plan has to be drafted by the board of directors, determining all the measures that must be taken to overcome the problems detected in the framework of an implementation schedule. In addition to this, the drafting of a debt restructuring plan may also be ordered at the AFA's initiative.

If the bank is financially struggling, yet is still in a position to reverse this situation and avoid entering into a resolution

process, the AFA may adopt certain preventive measures including, among others:

- to require the board of directors to call a general meeting or call to its constitution directly to adopt the corporate resolutions that may be considered necessary;
- to order cessation or dismissal of members of the board of directors or senior managers; or
- to appoint a representative in the bank to monitor its processes and assess its effectiveness.

Law stated - 31 December 2022

Insolvency

What are the legal and regulatory processes in the event that a bank becomes insolvent?

The AREB may initiate the resolution process if:

- a bank is not able to fulfil solvency and liquidity ratios, and falls into insolvency or will foreseeably do so;
- there is no likelihood that private sector measures will be able to prevent the insolvency within a reasonable period of time; and
- for reasons of public interest, it is necessary or convenient to wind up the entity, hence the dissolution or liquidation of the bank by means of bankruptcy proceedings will not reasonably allow the resolution objectives to be fulfilled.

There are several instruments for the resolution of a bank under Act No. 7/2021 that can be individually or jointly applied by the AREB, which are:

- sale of the bank's business;
- transfer of the assets and liabilities to a bridge entity;
- transfer of the assets and liabilities to a management company; or
- the internal recapitalisation of the bank.

However, it is also possible that banks will be subject to ordinary, court-driven insolvency proceedings (ie, under the general framework of the Insolvency Decree dated 4 October 1969) if, after the valuation process, the AREB reaches the conclusion that the objectives will not be fulfilled by the banking resolution process.

Law stated - 31 December 2022

Recent and future changes

Have capital adequacy guidelines changed, or are they expected to change in the near future?

Capital adequacy guidelines were amended on 20 December 2018 when the General Council approved the Capital Adequacy and Solvency Law that implemented CRD IV. On 6 March 2019, the General Council approved the regulation of the Capital Adequacy and Solvency Law, which implemented the CRR in Andorra.

Law stated - 31 December 2022

OWNERSHIP RESTRICTIONS AND IMPLICATIONS

Controlling interest

Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank (or non-bank). What constitutes 'control' for this purpose?

The creation or acquisition of entities, with a long-term project and acquiring a qualified stake, is subject to the prior consent of the Andorran Financial Authority (AFA) and subsequent registration.

A participation is considered 'qualified' when it reaches, either directly or indirectly, a percentage of 10 per cent of the capital or voting rights in the participated entity; or, regardless of its amount, it enables the holder to exercise 'significant influence'. In turn, 'significant influence' is defined as the power to intervene in the financial and business activity decisions of the entity, without having an absolute or joint control over it (eg, the capacity to appoint or dismiss a director is normally deemed as 'significant influence').

The AFA can deny the consent to the authorisation or the registration if, from the analysis of the documentation, reaches the conclusion that the act does not adjust to legislation in force or may negatively affect in a significant way the elements that are technical, economical or professional guarantees of the entity or its group. Additionally, prior to granting authorisation for the transaction, the AFA will request a report from the anti-money laundering authority – the Andorra Financial Intelligence Unit – which will also examine the transaction and the acquirer.

Law stated - 31 December 2022

Foreign ownership

Are there any restrictions on foreign ownership of banks (or non-banks)?

There are no general restrictions on foreign ownership of banks. Thus, foreign natural or legal persons may own banks without having to fulfil additional requirements, except for the prior obtainment of a foreign investment authorisation granted by the Andorran government.

The request form to the foreign investment authorisation has to identify the investor and explain the details of the business plan to undertake as well as the investment amount.

The Andorran government has up to 45 days to decide whether to grant the authorisation. However, if the authorisation is not resolved in that period, it is deemed as granted.

However, the Andorran government has a safeguard clause to deny such authorisation to protect the sovereignty, public and economic order, national security, public health or general interest of Andorra.

Law stated - 31 December 2022

Implications and responsibilities

What are the legal and regulatory implications for entities that control banks?

Entities that control banks fall under the supervision of the AFA for prudential purposes.

Controlling entities and holders of significant stakes are liable to administrative sanctions if they exercise a negative influence over, or otherwise destabilise, the bank in question.

Law stated - 31 December 2022

What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

The entity or individual that controls a bank as a parent company is subject to the suitability requirements that apply to directors of banking entities (ie, business reputation, suitable knowledge and professional experience). Hence, the parent company's proposal for appointing directors must be submitted to and analysed by the AFA prior to the appointment of these directors.

Additionally, according to Act No. 12/2018, if the home state regulator of the entity or individual that controls a bank incorporated in Andorra has signed a cooperation agreement for supervision on a consolidated basis with the AFA, the entity or individual shall comply with the following provisions in accordance with the terms of the specific cooperation agreement:

- transmitting all the information required by its home state regulator and, as the case may be, all the information regarding risk management to its parent company; and
- demanding the home state regulator to perform on-site inspections in relation to entities supervised by the AFA and vice versa.

Law stated - 31 December 2022

What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

Act No. 7/2021 expressly establishes that shareholders will be the first to bear the entity's losses, although they will not bear any losses to a higher extent than those accumulated if the entity had been subject to a general insolvency proceeding. Consequently, the loss that may be suffered by a shareholder is limited to its stake in the share capital.

Furthermore, the AREB is granted with extraordinary powers that enable it to adopt wide-ranging actions, which in practice could affect a controlling entity (eg, bail-in sequence or ordering structural modifications, such as a special purpose vehicle/controlling entity merger).

Law stated - 31 December 2022

M&A AND CHANGES IN CONTROL

Required approvals

Describe the regulatory approvals needed to acquire control of a bank (or non-bank). How is 'control' defined for this purpose? Do the requirements differ depending on the size or complexity of the institution?

The creation or acquisition of entities, with a long-term project and acquiring a qualified stake, is subject to the prior consent of the Andorran Financial Authority (AFA) and subsequent registration.

A participation is considered 'qualified' when it reaches, either directly or indirectly, a percentage of 10 per cent of the capital or voting rights in the participated entity; or, regardless of its amount, it enables the holder to exercise 'significant influence'. In turn, 'significant influence' is defined as the power to intervene in the financial and business activity decisions of the entity, without having an absolute or joint control over it (eg, the capacity to appoint or dismiss a director is normally deemed as 'significant influence').

The AFA can deny the consent to the authorisation or the registration if, from the analysis of the documentation, reaches the conclusion that the act does not adjust to legislation in force or may negatively affect in a significant way the elements that are technical, economical or professional guarantees of the entity or its group. Additionally, prior to granting authorisation for the transaction, the AFA will request a report from the anti-money laundering authority – the Andorra Financial Intelligence Unit – which will also examine the transaction and the acquirer.

The requirements do not differ depending on the size or complexity of the institution.

Law stated - 31 December 2022

Foreign acquirers

Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The AFA is receptive to foreign acquirers. The regulatory process does not differ substantially for a foreign acquirer, except for the requirement for a foreign investment authorisation.

The AFA has accepted the purchase of stakes in Andorran banks by foreign banks, as well as the incorporation of subsidiaries of foreign banks in Andorra. Therefore, the jurisdiction of a foreign acquirer is not an obstacle in itself, provided that the AFA can continuously perform its supervisory and regulatory activity.

Law stated - 31 December 2022

Under what circumstances can a foreign bank (or non-bank) establish an office and engage in business? For example, can it establish a branch or must it form or acquire a locally chartered bank?

Pursuant to the principle of reserve activity, under no circumstances a foreign bank can establish a branch and engage in business within the jurisdiction. Only locally chartered banks are authorised by the AFA to render financial or investment activities in Andorra. To this extent, a foreign bank can only incorporate a newly created entity (subject to AFA's authorisation) or acquire a locally chartered bank (note that authorisation requirements are also required).

Law stated - 31 December 2022

Factors considered by authorities

What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank (or non-bank)?

The key factors analysed by the AFA in the context of an acquisition of control of an Andorran bank are principally:

- the business reputation of the acquirer and the persons controlling it;
- the capacity of the bank to comply with the applicable regulatory and disciplinary rules stated in Andorran legislation;
- the directors and senior officers of the bank who may be appointed as consequence of taking control will have to comply with the suitability requirements of business reputation, experience, knowledge and independence;
- the absence of a significant negative effect on the elements that form the technical, economic and professional guarantees of the entity of which the control is acquired;
- absence of breach of the Andorran laws by the acquisition of control of an Andorran bank; and

- the existence of signs that may reasonably lead to suspicion that the transaction is related to money laundering or terrorism financing.

Law stated - 31 December 2022

Filing requirements

Describe the required filings for an acquisition of control of a bank. Do the requirements differ depending on the size or complexity of the institution?

The AFA will demand the following information to authorise the acquisition of control of a bank:

- information about the transaction, including:
  - purpose, price and payment terms;
  - identification of the entity;
  - impact on the distribution of voting rights;
  - financing of the transaction and existence of agreements with third parties or other shareholders in relation to the transaction;
  - documentation stating that there is no affection to the technical;
  - economic and professional guarantees of the Andorran bank; and
  - in the case of qualified stakes, that there is no breach of Andorran legislation;
- information about the acquirer and its controlling persons, including:
  - a certificate of the general meeting of the foreign entity that accords to the acquisition;
  - the identity of the acquirer and its controlling persons, group structure, structure and members of the management bodies as well as their reputation and experience;
  - their economic and financial situation;
  - verification or previous links with the acquired bank;
  - evaluations performed by anti-money laundering bodies; and
- impact on the bank's economic activity and impact on the Andorran economy:
  - business and strategic plans;
  - changes and structure of the corporate governance structure;
  - internal controls; and
  - anti-money laundering compliance procedures.

The requirements do not differ depending on the size or complexity of the institution.

Law stated - 31 December 2022

Time frame for approval

What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

For both domestic and foreign acquirers, the framework for regulatory approval is the same. Therefore, the AFA should hand down a decision on the acquisition accepting or opposing the transaction within 30 business days of submission of the application or, if applicable, from the date of submission of additional information.

The AFA may always choose to oppose an application. The foreign entity may file an administrative appeal against this decision before the competent Andorran courts.

Law stated - 31 December 2022

Regulatory trends

Are there any notable recent regulatory trends or developments affecting M&A and changes in control in the banking sector?

There have been no significant recent developments on M&A in the banking sector.

Law stated - 31 December 2022

UPDATE AND TRENDS

Key developments of the past year

Are there any emerging trends or hot topics in banking regulation in your jurisdiction?

The Andorran government and the International Monetary Fund (IMF) held negotiations that finally resulted in the General Council adopting a law on 5 October 2020 to enable Andorra to join the IMF.

In addition, Andorra is currently negotiating an association agreement with the European Union, aimed both at enabling the creation of new economic sectors and to internationalise existing sectors. In this regard, the alignment process of Andorran legislation is currently facing a twofold challenge: the regulatory challenge that derives from the Monetary Agreement, and the technological innovation and digital transformation process, which is already underway. The increasing challenges that Andorran banking entities are going to face derive from the need to develop both their own application programming interfaces and the interoperability that will be increasingly demanded.

Law stated - 31 December 2022

Jurisdictions

Andorra	Cases & Lacambra
Ghana	WTS Nobisfields
Greece	Zepos & Yannopoulos
Ireland	Dillon Eustace LLP
Israel	Arnon, Tadmor-Levy
Italy	Ughi e Nunziante
Japan	TMI Associates
Lebanon	Abou Jaoude & Associates Law Firm
Luxembourg	Loyens & Loeff
Singapore	WongPartnership LLP
South Africa	White & Case
Sri Lanka	Tiruchelvam Associates
Switzerland	Lenz & Staehelin
United Kingdom	1 Crown Office Row
USA	Debevoise & Plimpton