New investor protection regulation in Andorra (MiFID II)

I. Introduction

On 15 November 2023, the Andorran General Council ("*Consell General*") passed a draft bill (the "**MiFID II Draft Bill**") addressing new investor protection requirements and organizational aspects applicable to the operating entities of the Andorran financial system ("**Entities**"), with the aim to incorporate the provisions of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments ("**MiFID II**"), the Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, and – partially - the Commission Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits, in the Principality of Andorra ("**Andorra**"), as an amendment to Act 8/2013, May 9, which covers the organizational requirements and operating conditions of the operating entities in the Andorran financial system, the investor protection, the market abuse and financial securities agreements, as amended from time to time ("*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*") (the "**Financial Securities Act**").

As highlighted in the MiFID II Draft Bill, the financial sector holds paramount significance within the economy of Andorra, making it especially relevant that the regulations governing the Andorran financial sector align comprehensively with the highest international standards.

II. Background

In November 2011, the Andorran General Council approved the ratification of the Monetary agreement between Andorra and the European Union, dated 30

June 2011 ("*Acord monetari entre el Principat d'Andorra i la Unió Europea*") (the "**Monetary Agreement**"). The Monetary Agreement not only allowed Andorra to officially adopt the euro as its legal tender, but also outlined EU regulatory provisions to be implemented in Andorra, notably those pertaining to the banking and financial sector.

One of the most notable examples of transposition of the EU acquis can be found in the transposition of MiFID I in the Financial Securities Act (previously Act 14/2010). In subsequent years, following the line set by the European standard, the Andorran legislator has been amending the Financial Securities Act to include some issues relating to market abuse, master netting agreements/financial collateral arrangements and rules of conduct, as well as introducing EMIR regulations, transparency of securities financing transactions (SFTR) and benchmarks (BMR).

III. Purpose

The MiFID II Draft Bill has the main purpose to incorporate the provisions of MiFID II into the Andorran legal framework, for the purposes to align Andorran regulations with MiFID II standards.

This strategic initiative encompasses several aspects related to investment advisory services, portfolio management, suitability and appropriateness requirements, product governance, transparency, inducements, conflicts of interest, asset safeguarding, record-keeping, best execution and internal control measures.

IV. Structure of the MiFID II Draft Bill

The MiFID II Draft Bill - which includes the former text of the Financial Securities Act along with the new amendments - is organized into seven chapters, some of which are further divided into different sections, comprising a total of 121 articles. Additionally, this piece of law includes two additional provisions, one transitional provision, one derogatory provision, and six final provisions:

(i) **Chapter one.** *General provisions*

The MiFID II Draft Bill enhances the definition of "money market

instruments", including those with value that can be determined at any time, if they are not derivatives and have a maturity at the time of issuance of 397 days or less. Likewise, new definitions are introduced in terms of investment and ancillary services, order execution, liquid market, investment advice, matching of client orders, algorithmic trading and multilateral trading systems.

(ii) **Chapter two.** *Organizational requirements and operating conditions*

Sustainability factors and preferences - as well as the inherent risk associated to the investment value and how to include them in the suitability assessments - are mentioned for the first time in the Andorran legal framework. Hence, Entities are obliged to act according to the corporate social responsibility principles and must report this information periodically. However, the MiFID II Draft Bill does neither develop ESG taxonomy (e.g. Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment) nor specify these requirements in more detail.

Another relevant issue is the introduction of product governance rules: (i) the obligation to have an approval mechanism for financial instruments - with the monitoring by the compliance function -; (ii) the identification of the target market; and (iii) the periodic review. The text empowers the Ministry of Finance to specify regulatory requirements on product design, creation, and distribution.

As far as remuneration is concerned, it is made clear that remuneration should not be based exclusively on quantitative commercial criteria, but on qualitative criteria reflecting compliance with the rules of conduct, and especially when the client qualifies as retail investor - in connection with the conflict of interest management policy -.

The text also provides for specific requirements in relation to the underwriting and placement of financial instruments (e.g. conflict of interest management mechanisms and internal procedures), as well as in

relation to investment advice, distribution, self-placement and algorithmic trading. It is important to note that there is currently no Andorran regulation on securities issuance, which means that there is still a lack of legislative development in this area.

Another new development introduced by the draft bill in the framework of the safeguarding of client assets is the prohibition of creation of pledges or other security interests or the entering into netting agreements on financial instruments or client funds that allow a third party to use them to recover debts that do not belong to the client, except where permitted by the law of the jurisdiction of the country where the client's funds or instruments are located. In addition, Entities are not allowed to enter into title transfer financial collateral arrangements with retail clients.

As for new obligations in the area of conflict of interests, the draft bill adds the obligation for Entities to review the policy on an annual basis, as well as the procedure for disclosure to the client. Lastly, the procedure for handling customer complaints and the requirements applicable to the recording of telephone conversations or electronic communications are also further developed.

(iii) **Chapter three.** *Investor protection*

To begin with, retail investor protection is reinforced, and new obligations are also included for professional clients – information, risk disclosure and reporting register - and eligible counterparties – information and classification procedure-. In terms of information on financial instruments, the MiFID II Draft Bill requires Entities to inform about the risks associated with financial instruments, their leverage effect, risks associated with the insolvency of the issuer, price volatility, potential restrictions, the existence of other financial commitments or mandatory margins.

Most notably, however, is the provision on inducements in line with the European standard. Thus, Entities are allowed to pay or to be paid any fee or commission, or to provide or to be provided with any non-monetary

benefit in connection with the provision of an investment service or an ancillary service, to or by any party except the client or a person on behalf of the client, other than where the payment or benefit: (i) is designed to enhance the quality – note that this concept is also developed in the draft bill - of the relevant service to the client; and (ii) does not impair compliance with the Entity's duty to act honestly, fairly and professionally in accordance with the best interest of its clients. In addition to this, the existence, nature and amount of the payment or benefit aforementioned, or, where the amount cannot be ascertained, the method of calculating that amount, must be clearly disclosed to the client, in a manner that is comprehensive, accurate and understandable, prior to the provision of the relevant investment or ancillary service. In addition to this, the Entity shall also inform the client on mechanisms for transferring to the client the fee, commission, monetary or non-monetary benefit received in relation to the provision of the investment or ancillary service.

It is specified that for investment advisory services provided on an independent basis - new concept - and discretionary portfolio management, the Entities may not accept or retain fees, commissions or other monetary or non-monetary benefits - apart from those considered "minor" (e.g. information on the product or service, marketing materials) -; and must return them to the client as soon as possible. Likewise, Entities are obliged to reveal - a priori - to the client the amount of the inducement, or, where applicable, the calculation method; in addition to maintaining a specific record. In relation to research reports, it is specified that these are not considered an inducement if they are received in exchange for any of the following elements: (i) direct payments charged to the Entity's own resources, (ii) payments charged to a research payment account provided that a series of conditions are met.

As far as people who provide investment advisory services or provide information on financial services or instruments are concerned, Entities are obliged to provide the Andorran Financial Authority ("**AFA**") with the documentation and information that proves that the individuals acting on

their behalf have the necessary knowledge and skills. This point must be developed by the AFA via technical communication (e.g. official certifications, minimum content of the training, review, etc). Likewise, new obligations are introduced on reporting information to clients in investment advisory services.

Finally, in terms of execution orders, the text adds new information to be included in the best execution policies (e.g. annual publication of the 5 main intermediaries, information on trading venues by category of financial instruments, factors to select a trading venue, executions carried out outside a trading venue, margins, etc.).

(iv) **Chapter four.** *Market abuse*

The information to be sent to the AFA is developed in the event of a suspicious transaction of market abuse.

(v) **Chapter five.** *Close-out-netting agreements and collateral arrangements*

No changes have been included.

(vi) **Chapter six.** *Over-the-counter derivatives*

Financial counterparties may continue to apply risk management procedures to OTC derivative contracts that are not cleared and that have been entered into or have been subject to novation before December 15, 2022, if after the entry into force of the law, these contracts are modified or are subject to novation by replacing a benchmark or a supplementary clause.

(vii) **Chapter seven.** *Transparency of securities financing operations*

No changes have been included.

(viii) **Additional provisions.**

The first additional provision subjects Chapters One, Two, and Three to the sanctioning regime established by the Financial System Disciplinary Regime Law of November 27, 1997. The second additional provision clarifies that all references to the Financial Securities Act in any law or regulatory provision should be understood as referring to this new law.

(ix) **Transitional provision.**

This provision establishes that Article 34 *quarter* - knowledge and competencies required for individuals providing investment advice or information -, becomes applicable one year after the law's entry into force.

(x) **Derogatory provision.**

This provision repeals the Financial Securities Act.

(xi) **Final provisions.**

Among others, the final provisions amend Act 7/2013, May 9, of the regime for the operating entities in the Andorran financial system and other provisions which govern the financial activities at the Principality of Andorra ("*Llei 7/2013, del 9 de maig, sobre el règim jurídic de les entitats operatives del sistema financer andorrà i altres disposicions que regulen l'exercici de les activitats financeres al Principat d'Andorra*") (the "**Financial Act**") to align it with European standards – definitions and infringements -. Likewise, the services related to commercial reports, corporate advisory and renting are not under the reservation activity regime.

The Government is also empowered to develop regulatory requirements and to publish a consolidated text of all the regulations affected by this draft bill within a period of 6 months from its entry into force - three (3) months after its publication in the Andorran Official Gazette (BOPA) -.

V. Practical impacts and preliminary conclusions

From an initial analysis of the MiFD II Draft Bill, the following key impacts and preliminary conclusions have been clearly observed:

(i) **Key legislative milestone**: MiFID II transposition in Andorra is a long-awaited legislative development anticipated by the Andorran financial sector, marking a significant stride towards aligning local financial practices with international standards.

(ii) **Need for further development**: Absence of specific regulations addressing capital market issuances and corporate laws underscores the need for continued legislative development to establish a well-rounded

and robust legal framework. Notably, the regulatory framework is still pending the inclusion of MiFIR - public information on the volume and cost of certain transactions, reporting obligations - (Level 1) and Pilot Regime, PRIIPs, and specific requirements on ESG (sustainability-related disclosures and the establishment of a framework to facilitate sustainable investment), product governance, and other provisions stated in Level 2 and 3 EU regulations, in view of the fact that the third amendment of MiFID is currently being under review in Europe (e.g. transparency on capital markets industry, inducements, pricing).

(iii) **Impact on Entities**: Substantial impact on Entities is expected, particularly those unfamiliar with MiFID II's provisions. This emphasizes the importance of adaptation for local businesses. Andorran entities are mandated to adhere to stringent product governance requirements. Simultaneously, other actors, such as asset managers, financial advisors, face the challenge of adapting to the complexities introduced by the new regulatory framework.

(iv) **Inducements**: Inducement restrictions will lead to changes in the policies of some Entities, and they will need to take a position on whether they provide investment advice on an independent basis or on a non-independent basis.

(v) **Strengthening trust in foreign entities**: On a positive note, foreign entities can view this regulatory development as encouraging. The alignment of local operators with international standards provides increased confidence and comfort for foreign entities operating within Andorra, enhancing the competitiveness of the local financial landscape.

(vi) **Reverse solicitation**: The MiFID II Draft Bill has not introduced the concept of reverse solicitation when providing investment services on a cross-border basis by foreign entities.

(vii) **Challenges for the AFA**: The AFA faces the challenge of effectively monitoring and enforcing the new regulatory landscape, requiring strategic measures to ensure compliance and mitigate risks.

(viii) **EU integration**: Ultimately, MiFID II brings a more globally integrated and compliant business environment, contributing to the overall stability and attractiveness of Andorra as a financial hub, which is expected to positively contribute to the sustainable development of the financial sector, strengthening investor confidence in the Andorran market.

VI. Status and prospective timings

The transposition of MiFID II in Andorra is currently in the amendment phase. Given its specific characteristics, approval is anticipated in the first quarter of 2024 or even before the summer.

However, it is essential to note that the final timeline will be contingent on the progress of negotiations related to the association agreement between Andorra and the European Union.

By way of conclusion, investor protection and financial products design are the two main drivers of the new regulation. However, the present proposal must be considered a featureless legal text in the absence of proper second and third level developments. And its actual impact is to be highly depending on the enactment of a comprehensive legal framework for capital markets activities. Quite likely, the strengthening of political and economic ties with the European Union is to play a role of paramount importance to achieve the still pending goals.

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Our Financial Services team in the Andorran office will be pleased to provide you with more information.

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