SM/03/93

March 13, 2003

To: Members of the Executive Board

From: The Secretary

Subject: **Andorra—Publication of Offshore Financial Sector Assessments**

Attached for the **information** of the Executive Directors is the staff's assessment of the offshore financial sector of Andorra. Management has consented to a request by the Andorran authorities to publish the assessment, in accordance with the practices and procedures described in SM/01/228 (7/16/01), which they intend to do at noon, on March 21, 2003. The assessment will also be posted on the Fund's external website on the same day.

Questions may be referred to Mr. M. Moore, MAE (ext. 38631).

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INTERNATIONAL MONETARY FUND

Monetary and Exchange Affairs Department

ANDORRA

ASSESSMENT OF THE SUPERVISION AND REGULATION OF THE FINANCIAL SECTOR

August 2002

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PREFACE

In July 2000, the Executive Board approved a program of assessments on the basis of a paper "Offshore Financial Centers—The Role of the IMF" published in July 2000. In this context, the government of Andorra invited the IMF to carry out an assessment in February 2002 of the extent to which the regulatory and supervisory arrangements for the financial sector complied with certain internationally accepted standards. The activities of Andorran financial institutions include resident and non-resident alike, with no difference in the supervisory and regulatory arrangements for domestic and offshore activities. The assessment was carried out on the basis of the "Module 2" approach.[1]

The assessment was carried out by a team led by Michael Moore (Monetary and Exchange Affairs Department, IMF), Ms. Moni Sengupta (the Legal Department, IMF), Mr. Saul Carpio, (banking supervision expert from the US Comptroller of the Currency, USA), Ms. Marie-Christine Dupuis (anti-money laundering expert from the United Nations Global Program against Money Laundering, Austria) and Mr. Guillaume Leroy (insurance consultant, France). The team received excellent cooperation and hospitality from the staff of the Ministry of Finance, the Andorran National Institute of Finance (INAF), the Unit for Prevention of Laundering (UPB), and private sector bodies.

To conduct the assessments, the mission held discussions with the Finance and Justice Ministries, INAF, the UPB, the banks, bankers association, audit firms and the bank rating firm, Fitch-IBCA. Meetings were also held with the Ministry of Finance and insurance brokers/agents. The mission also met with officials from the Bank of Spain regarding arrangements for consolidated supervision of banks operating in Andorra that are controlled by Spanish banks.

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[1] A Module 2 assessment is described in SM/00/136, *Offshore Financial Centers-The Role of the IMF.*

I. Executive Summary

1. At the request of the Minister of Finance of the Principality of Andorra, an MAE mission visited Andorra during the period February 4–14, 2002, to assess observance of financial sector supervisory standards in the context of a stand-alone (Module 2) assessment.

2. The mission undertook a Module 2 assessment in accordance with the procedures agreed upon by the IMF's Executive Board in July 2000.[2] The assessment considered compliance with supervisory and regulatory principles relative to the Basel Core Principles for Effective Banking Supervision in the banking sector. In addition, there was an evaluation of Andorra's anti-money laundering mechanisms, using the IMF and World Bank expanded anti-money laundering methodology.[3]

3. At end September 2001, there were eight licensed banks in Andorra with total assets of 11.8 billion euros. Spanish banks control five of the eight banks, or 71 percent by assets. The remaining three banks are locally controlled Andorran banks, representing 29 percent by assets. Insurance business is largely confined to activities with Andorran residents while securities activity is limited to funds management activities, carried out through both banks (and their affiliates), and fund management firms. Wealth management companies are also present, though the volume is very low.

4. The results of the assessment indicate that financial sector supervision is generally sound with respect to material activities of the financial system. This view largely reflects considerations of the supervision of banking activities, which represent in excess of 95 percent of all financial sector activities. There is a generally high compliance with international standards for anti-money laundering. Efforts are underway by authorities at INAF, the UPB and the Ministry of Finance to address those principles and recommendations not fully compliant. Specific conclusions are provided for in Sections III and IV of this report.

5. Legislation is pending that should allow for greater autonomy of INAF, as well as a more streamlined mechanism for financial sector supervision. The mission observed a high degree of professionalism within INAF, though the mission observed a cumbersome process to assure independence in INAF's role as the supervisor of financial institutions. The authorities express that the issue of resources can be met through the government's budget process. That said, the mission observes that the current framework for funding of INAF is strained, with little capacity for increasing its level of activity. The professionals at INAF

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[2] A Module 2 assessment is described in SM/00/136, *Offshore Financial Centers-The Role of the IMF.*

[3] For the review of anti-money laundering, the mission observed the guidance in the draft AML/CFT methodology document that was issued to the IMF's Executive Board on February 7, 2002 (SM/02/40).

carry out their duties diligently and demonstrate a good knowledge of supervised institutions and their activities.

6. The mission also reviewed supervisory and regulatory arrangements for the securities and insurance sectors. Securities activity is limited to fund investments, carried out largely through banks and their affiliates; several small non-bank related funds management firms are also in operation. This activity increased substantially in the last decade as bank clients have channeled some of their deposits to higher yielding investment funds. At end September 2001, banks' customer deposits were 8.3 billion euros while the value of third party investments in custody had grown to 12.7 billion euros. INAF is actively monitoring banks' funds management activities, and wealth and fund management companies through quarterly reporting and external audit coverage.

7. Since securities activities are limited and highly integrated with banking activities, a full assessment of compliance with the IOSCO Objectives and Principles of Securities Regulation was not undertaken. The mission, however, reviewed several IOSCO principles pertinent to Andorra, and recommended that securities' legislation (now being drafted) bolster INAF's mandate for protecting investors.

8. The insurance sector is estimated to be less than 1 percent of the financial system assets; however comprehensive or current statistics are limited. Insurance products are sold through Andorran companies, substantially owned by Andorran banks, or through delegations of foreign insurance companies, primarily from Spain and France. Given the small presence of the insurance industry, the mission did not assess compliance with the insurance supervision standard as issued by International Association of Insurance Supervisors (IAIS).

9. Observations and conclusions on the supervision for the insurance sector will be contained in a separate Fund technical assistance report. The preliminary findings are that (i) supervision of insurance should formally be included within the functions of INAF, which will entail a modification to the insurance law and other enabling legislation; (ii) that INAF work to develop a common chart of accounts for insurance providers (e.g., companies and delegations); and (iii) that INAF define complementary audit instructions for external auditors in a manner consistent with actions taken for banks.

II. Background

A. Regulatory and Supervisory Framework of the Financial Sector

Regulatory and supervisory authorities

10. Andorra, with five of its eight banks substantially owned by Spanish Banks, had a self-regulating banking system until 1993, which followed guidelines established by the Andorran Bankers Association (ABA). In 1990, the banks signed an accord to self-regulate the banking system in line with Basel principles, the most important relating to the

maintenance of adequate capital, external audit requirements, fit and proper criteria for officers, banking secrecy and anti-money laundering.

11. The government of Andorra remains the ultimate authority over the country's financial system through the Ministry of Finance. Except for insurance business, direct regulatory oversight responsibilities have been delegated to two bodies—the Supreme Finance Commission (*Comissió Superior de Finances* - CSF) and the Andorran National Institute of Finance (*Institut Nacional Andorrá de Finances,* INAF). The insurance sector remains under the direct oversight of the Ministry of Finance.[4]

12. The CSF reports to the Ministry of Finance and is the highest executive body responsible for supervising the financial system. It submits proposals to the government presented by the INAF for new banking licenses and liaises between the INAF, banks, and judicial bodies. It is also responsible for imposing disciplinary action for non-compliance with prudential requirements and regulations relating to money laundering activities. The CSF's President and Vice President are the Minister of Finance and the Director General of the INAF, respectively. Other members are a magistrate appointed by the judiciary and three professionals from the private sector.

13. INAF was established in 1989 as a public financial institution with its own legal personality. It has direct responsibility for ongoing supervision of the financial system. Day-to-day monitoring of the condition of all financial institutions (with exception of insurance companies) is the responsibility of INAF under the 1993 *Law amending the law on the Creation of the Andorran National Institute of Finances* (The 1993 INAF Law). INAF's functions include the day-to-day monitoring of financial institutions for compliance with rules and regulations, including requirements of auditors; limited onsite inspection powers; initiation of laws and regulations for the financial sector; calculation of the solvency ratio, liquidity ratio and reports on the creation of new banks; and, initiation of disciplinary or enforcement proceedings for submission to the CSF.

14. The Finance Minister makes the final judgment regarding approval of regulations; the issuance of rulings on administrative sanctions for violations; authorization of on-site inspections by INAF if the CSF refuses to allow the inspection; sanctions for violations of the rules on money-laundering, in the case of serious and very serious violations; and at the request of the CSF and INAF the granting of licenses for new financial institutions.

15. In 2001, Andorra established the Unit for Prevention of Laundering (UPB). UPB has clear responsibilities in ensuring compliance by financial institutions with applicable laws and regulations to prevent money laundering.

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[4] The authorities are considering moving the direct responsibility for oversight of the insurance sector to INAF, which would then have responsibility for supervision of all of the primary financial services areas.

Laws governing the financial sector

16. The *Law regulating the financial system* was passed in November 1993 to provide a general framework for the financial system and the promulgation of regulations. The 1993 Law provides for the oversight functions of banks, specialized credit, and other institutions including investment and fund management companies by INAF, with additional oversight responsibilities assigned to the CSF and Ministry of Finance. Within the financial sector, only the activities of insurance companies presently do not come in under INAF. Also, in 1993, the duties of INAF were substantially revised by the *Law amending the law on the Creation of the Andorran National Institute of Finances* (The 1993 INAF Law). For primary legislation related to the banking sector see section on *Laws Governing the Banking Sector* within the assessment of the Basel Core Principles, Chapter III.

17. Andorra's legal framework in anti-money laundering and combating the financing of terrorism is largely contained in the Law on international co-operation on penal matters and of fight against money laundering or proceeds resulting from international criminal activities (2000 AML Law) which came into effect in June 2001. The 2000 AML Law provides for formalized international mutual cooperation on criminal matters, creates and empowers UPB with exclusive jurisdiction over money laundering investigations and supervision, provides comprehensive customer due diligence and recordkeeping requirements for financial intermediaries, and provides detailed suspicious transaction reporting requirements.

18. Several other laws govern activities in the financial sector. The laws are supplemented by technical communications issued by INAF and the UPB. The INAF communications are readily available from its web site. The legal framework for the banking sector largely has kept pace with international developments, this cannot be said for the much smaller insurance sector, which is dependent on now out-dated legislation, and a weak regulatory mechanism.

B. Previous Reviews

19. A Fund mission visited Andorra in January 2001 to discuss the results of the authorities' efforts to complete a Module 1 self-assessment. That visit provided an opportunity to discuss Andorra's supervisory arrangements and to identify areas for review in the context of the current Module 2 assessment.

20. The Financial Stability Forum (FSF) convened a working group to consider the significance of offshore financial centers in relation to financial stability in 1999. Based on the results of the working group, the FSF released in May 2000 its rankings of offshore financial centers according to three groupings. Andorra along with 7 other countries and territories was categorized in Group II, the middle ranking group. The FSF defined Group II jurisdictions as those generally seen as having procedures for supervision and cooperation in

place, but where actual performance falls below international standards, and there is substantial room for improvement. [5]

21. A team of Council of Europe's Select Committee of Experts (PC-R-EV) (which included two representatives of the Financial Action Task Force) visited Andorra in March 1999. Their First Evaluation Report on the Principality of Andorra was generally favorable, describing the Andorran anti-money laundering regime as resting "on sound bases from both the criminal law and regulatory standpoints." In addition, the Report noted the efforts by banks and government to adopt effective anti-money laundering measures. The PC-R-EV report suggested that some law revisions would be appropriate, including: (i) creation of a separate financial intelligence unit; (ii) expansion of the list of predicate offenses; (iii) enlargement of diligence obligations, especially the know your customer and record keeping rules, to include non-financial legal and natural persons; and (iv) creation of specific powers for INAF to complement the independent external audits.

III. Assessment of Implementation of the Basel Core Principles for Effective Banking Supervision

A. Overview

General

22. This assessment of Andorra's implementation of the Basel Core Principles for Effective Banking Supervision was conducted as part of the Module 2 assessment.[6]

23. The results of our assessments indicate that financial sector supervision is generally adequate with respect to material activities of the financial system though the report provides several areas for strengthening. This view largely reflects considerations of the supervision of banking activities, which represent approximately 95 percent of all financial sector activities. Efforts are underway by authorities at INAF and the Ministry of Finance to implement recommendations and address those principles not fully compliant. Certain of these will require changes in legislation as well as an augmentation to resources to assure an effective level of implementation.

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[5] The other two groupings are: Group I—jurisdictions generally viewed as cooperative, with a high quality of supervision, which largely adhere to international standards and Group III—jurisdictions seen as having a low quality of supervision, and/or being non-cooperative with onshore supervisors, and with little or no attempt being made to adhere to international standards.

[6] The assessment of compliance with the Basel Core Principles was conducted by Saul Carpio (Office of the Comptroller of the Currency, USA), and Michael Moore (MAE).

24. There is a high level of compliance with the Basel Core Principles for Effective Banking Supervision. Andorra is compliant with 14 of the principles, largely compliant with 13 and materially non-compliant with 2. BCP-24 addressing contact with host country supervisors was not applicable due to the absence of material or active offices of Andorran banks in foreign countries at this time.

Information and methodology used for assessment

25. Extensive discussions were held with management and staff of INAF, the Ministry of Finance, the banks, bankers association, audit firms and Fitch-IBCA (the bank rating firm). The mission also met with officials from the Bank of Spain regarding arrangements for consolidated supervision of banks operating in Andorra that are controlled by Spanish banks. This assessment of the Basel Core Principles for Effective Banking Supervision (BCP) is based on the Core Principles Methodology of the Basel Committee on Banking Supervision (October 1999) and takes into consideration the essential criteria for effective supervision.

26. Documents and written materials examined included laws and regulations for the financial sector and the authorities' reply to a detailed IMF questionnaire provided in advance of the mission. The authorities were well prepared for the banking sector assessment, having completed a Module 1 self-assessment in the first quarter 2001. The mission received excellent cooperation from all those that it met.

Institutional and market structure overview

27. Andorra's financial sector revolves around the activities of eight banks. The banks are responsible for most private banking activity, including funds management activities, as well as providers of life insurance products. Of the eight banks in Andorra, five are substantially controlled by Spanish banks. Although a review of financial indicators was not within the scope of the assessment, the banks appear solidly capitalized, with good asset quality, liquidity and profitability. Based on discussions with bankers, the banks appear to be well managed. The eight banks had assets of 11.8 billion euros, and off-balance sheet activity of 21.6 billion euros concentrated in third party investments in custody at end-September 2001. The banking system is oriented to serve clients and depositors residing both in Andorra and abroad. Given the proximity to Spain and France, substantial business activity is with residents of these two countries.

Table 1. Andorra: Banking System
(In millions of euros as of September 30, 2001)

Banks by controlling shareholder	Employees	Percent of total		Assets	Percent of total	Deposits	Percent of total	Capital	Percent of total
Majority Andorran:									
- Banc Agricol i Commercial d'Andorra, SA	193	17.0		1,609.2	13.6	1,322.0	13.2	191.5	18.1
- Banca Reig, SA	151	13.3		1,144.3	9.7	977.1	9.8	110.1	10.4
- Banca Privada d'Andorra, SA	127	11.2		706.2	6.0	644.5	6.5	40.0	3.8
Total Andorran controlled banks	471	41.5		3,459.7	29.3	2,943.7	29.5	341.6	32.3
Majority Spanish:									
- Credit Andorra, SA	279	24.6		3,553.0	30.1	2,909.6	29.2	368.3	34.8
- Banc Internacional d'Andorra, SA	257	22.7	/1	2,455.4	20.8	2,145.9	21.5	167.7	15.8
- Caixa Bank, SA	95	8.4		1,189.0	10.1	1,029.5	10.3	74.3	7.0
- Banca Mora, SA	-	-	/1	983.2	8.3	827.7	8.3	76.7	7.2
- BancSabadell d'Andorra, SA	32	2.8		165.7	1.4	124.4	1.2	30.1	2.8
Total Spanish controlled banks	663	58.5		8,346.3	70.7	7,037.1	70.5	717.1	67.7
Total Banking System	1,134	100.0		11,806.0	100.0	9,980.8	100.0	1,058.7	100.0

/1 Banca Mora, S.A. is wholly owned by Banc Internacional d'Andorra and employee information is collected on a combined basis.

Source: INAF

B. General Preconditions for Effective Banking Supervision

28. The Disciplinary Law provides the range of powers available to INAF and the CSF to bring about corrective action for non-compliance with laws, regulations. The Solvency and Liquidity Law for financial institutions empower INAF to promote strong capital and liquidity requirements over Andorran financial institutions. Mechanisms for orderly resolution of insolvent institutions would include involvement of INAF.

29. The Bank Administration Law specifies requirements for external auditors, including disciplinary measures that INAF/CSF can impose against them.[7] Article 10, defines the obligations of the auditor and the possible sanctions for not complying with the law. External auditors have a duty to report instances where they become aware of the existence of suspicious facts or incidents, which could gravely affect the solvency, liquidity, and the stability of the banking institutions. Non-compliance could expose auditors to fines up to approximately euros 150,000 and suspension from being able to work in Andorra for up to

[7] Per Article 7 of the Disciplinary Law, the CSF is the formal body to decide sanctions. In practice, action would be taken only with the recommendation of INAF.

five years or permanently depending on severity of the infraction. In the past two years, there have been no cases involving penalties to auditors.

30. Pursuant to Article 12 of the Disciplinary Law, INAF may recommend to the CSF enforcement and/or corrective measures over financial institutions, and individuals affiliated with regulated financial institutions, including employees, the management, boards of directors, etc. The most severe power under the Disciplinary Law, is the ability to revoke the banking license, which can only be taken with the authorization of the Finance Minister.

31. Andorra does not have formal deposit insurance nor is there a lender of last resort mechanism. However, the 1995 *Law regulating bank reserves used to guarantee deposits* requires that all banks participate in a guarantee fund administered by INAF that has as the purpose to guarantee solvency for Andorran banks. In practice the fund provides an indirect mechanism for taxing banks. According to the law, banks must deposit on behalf of the government 2.25 percent of their assets net of capital and interbank deposits. The banks do not receive any remuneration for funds placed on behalf of the government, but the government receives the benefit from investing the funds. The funds are deposited in banks, and would be available to facilitate resolution of a troubled financial institution. How the fund would be used in the event that there were a problem with one of Andorra's banks is unclear as there is little in the way of specific documentation for how the fund would operate in practice.

Laws governing the banking sector

- The 1996 Law regulating the solvency and liquidity criteria of banking institutions (The Solvency and Liquidity Law) establishes a minimum capital ratio of 10 percent, and a minimum liquidity ratio of 40 percent.

- The 1996 Law regulating the minimum capital requirement (1996 Capital Law) for banking institutions establishes a minimum capitalization requirement equal to Ptas 5 billion or approximately EUR 30 million.

- The 1996 Law regulating the operational activities of entities in the financial sector establishes permissible activities for financial institutions.

- The 1997 Law regulating the disciplinary rules within the financial sector (the Disciplinary Law) provides for corrective actions and strictness in the exercise of professional financial duties and to protect the financial system.

- The 1998 Law regulating the creation of new banking institutions (1998 Creation Law) established the requirements for authorization of new banking institutions during 1999 and 2000.

- The 1998 Law regulating the basic administrative rules of banking institutions (Bank Administration Law) imposes specific qualification requirements for general management and the requirement for external audit. As well, it specifies requirements

for external auditors, including disciplinary measures that CSF can impose against them. The same law allows foreigners to acquire up to 51 percent of the ownership in Andorran banking institutions.

- The 2000 Law on International Criminal Cooperation and Combating the Laundering of Money or Valuables Resulting from International Crime was passed in December 2000 (the 2000 AML Law) and came into force in July 2001.

- The 2000 Decree approved the Chart of Accounts that imposed accounting principles, criteria, and basic accounting definitions for Andorran financial institutions.

Recommendations

32. In consideration of pending legislation for the financial sector, the mission advocates the further strengthening of the autonomy of INAF, including assurance of greater independence for funding and staffing resources, and that it formally be assigned responsibility for the supervision of the insurance sector.

33. The mission recommends that securities legislation bolster INAF's mandate for (i) protecting investors by working to prevent market manipulation and fraud, and (ii) promoting market transparency. The new legislation should also delineate what actions constitute offenses under the securities law and provide for sanctions for such violations, and explicitly provide for INAF's power to use inspections and enforcement powers with respect to non-bank investment firms. INAF should be given explicit mandate to ensure banks and investment management firms provide adequate financial disclosure to investors.

34. To foster greater market discipline, INAF should encourage financial institutions to continue to strengthen financial statement disclosures, and promote the development of a private-sector credit bureau to enhance the transparency of borrowers' total indebtedness in the financial sector.

35. The mission cautions against adding ancillary functions to INAF that are not sufficiently compatible with its financial sector supervisory functions. The mission notes the intention that INAF perform the role of ensuring accuracy of tax reporting by financial institutions. This is not a function that coexists well within an agency whose primary responsibility is to ensure the financial health of individual institutions and the overall financial system. One needs to be mindful of the already limited resources of INAF and that additional non-supervisory activities will draw away scarce resources from core supervisory functions. In the context of the review of staffing, the prioritization of work needs to be the area of banking supervision and those functions that support this mission.

36. The mission concludes that a deepening of the supervision function is needed. Particularly, the mission recommends that the INAF develop a limited capacity to carry out onsite inspections. While reliance on external auditors is still very much an accepted approach to supervision, evolving internationally is the more accepted practice that financial sector supervisors have their own limited capacity to carry out onsite inspections. This is

particularly important in today's environment where there is an increasing demand on auditors for services other than traditional accounting activities. A capacity within INAF to conduct limited-scope inspection would provide a useful safeguard to the traditional reliance on the activities of external auditors. Particularly, INAF should have a case-by-case capacity to review onsite the adequacy and compliance with internal control policies, credit underwriting and market risk.

37. The capacity to carry out effective supervision appears affected by inadequate independence of INAF as the bank supervisor. The independence is affected by concerns for adequacy of resources. Within INAF, the position of deputy general manager remains unfilled, the ability to attract and retain staff and to hire qualified individuals at mid-career, also appears strained. INAF's ability to employ outside experts to deal with special situations and to provide regular training opportunities for supervisory staff is uncertain given current funding arrangements. The mission recommends that the INAF in addition to ongoing supervisory monitoring activity, develop a credible capacity to carry out onsite inspections of regulated financial institutions. The recommendation will entail an increase in the budgeting needs beyond those currently identified.

38. From the standpoint of consolidated supervision, the majority of insurance activities are conducted in the insurance subsidiaries of banks. Therefore, the *de facto* responsibility for insurance supervision largely resides within INAF, even though formal responsibility is with the Ministry of Finance. The mission recommends that the supervision responsibility be formalized through revisions to legislation as necessary to re-assign insurance supervision to INAF.

39. To the extent that INAF has limited resource capacity to conduct onsite inspections, and the use of external auditors for onsite supervision is not well developed, there is not yet an adequate process whereby the home country supervisor can confidently rely on the supervision carried out by INAF. The restrictions on the ability of the foreign supervisor (i.e., Bank of Spain) to inspect onsite the activities of subsidiaries impose a restriction that impedes consolidated supervision. Pending efforts to modify legislation to allow INAF to enter into arrangements with foreign supervisors will help to facilitate consolidated supervision.

40. Greater capacity building is needed for onsite/offsite supervision (see BCP 16 and BCP 19) by INAF, including deepening of the work for external auditors, as well as the building of a credible capacity to carry out onsite inspections. The strengthened capacity within INAF would allow the home country supervisor to have greater level of assurance regarding the adequacy of supervision of subsidiaries in Andorra. Pending legislation will afford greater independence on INAF to enter into supervisory arrangements with foreign supervisors, which is strongly encouraged. Moreover, the communication between INAF as the host supervisor and the Bank of Spain as the home supervisor would be aided through bilateral meetings at a frequency of at least once a year, or as often as mutually agreed between INAF and the Bank of Spain.

41. The mission recommends that the Finance Ministry and INAF review the 1995 *Law regulating bank reserves used to guarantee deposits* and together with industry develop implementing regulations and policies to guide the actions of authorities in the use of the guarantee fund to provide liquidity and/or effect the orderly resolution of a troubled financial institution.

Principle-by-principle assessment

Table 2. Detailed Assessment of Compliance of the Basel Core Principles

Principle 1.	**Objectives, Autonomy, Powers, and Resources** An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks. Each such agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to the authorization of banking establishments and their ongoing supervision; powers to address compliance with laws, as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Principle 1(1)	An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks.
Description	Prudential supervision and regulation for banking activities is split between the Andorran National Institute of Finance (INAF), the Comite Superior de Finanzas (the CSF) and the Finance Minister. Day-to-day monitoring of the condition of all financial institutions (with exception of insurance companies) is the responsibility of INAF under the 1993 *Law amending the law on the Creation of the Andorran National Institute of Finances* (The 1993 INAF Law). INAF's functions include: day-to-day monitoring of financial institutions for compliance with rules and regulations, including identification of requirements to be complied with by auditors; limited onsite inspection powers; initiation of laws and regulations for the financial sector; calculation of the solvency ratio, liquidity ratio and reports on the creation of new banks; and, initiation of disciplinary or enforcement proceedings for submission to the CSF. The 1993 INAF law also creates the CSF, which is an executive body between INAF and the Ministry of Finance on matters of recommending enforcement actions against regulated financial institutions, and the legal review and submissions of new rules and regulations prepared by INAF. The Finance Minister has the final say on matters regulating the financial sector after receiving the recommendations of the CSF and INAF. The Finance Minister makes the final judgment regarding approval of regulation; the issuance of rulings on administrative sanctions for violation; authorization of on-site inspection by INAF if the CSF refuses to allow the inspection; imposition of sanctions for violations of the rules on money-laundering, in the case of serious and very serious violations; and at the request of the CSF and INAF the granting of licenses for new financial institutions. INAF and CSF would participate in deciding measures to resolve problem bank situations. That said there has not been an incidence of a problem bank since the creation of INAF and CSF. The 2000 AML Law creates the Unit for Prevention of Laundering (UPB). UPB has clear

	responsibilities in ensuring compliance by financial institutions with applicable laws and regulations to prevent money laundering. (See BCP 15 and separate report on AML/CFT) for full discussion.
Assessment	Materially non-compliant
Comments	The processes for virtually all actions of INAF are encumbered by the requirement for prior approval and/or consent of the Finance Minister and CSF. The requirement introduces approval requirements that seriously limit the independence of INAF in all areas of supervision. The INAF should have authority to determine applicable regulation and supervisory policies within the constraints of the law. These should include the ability to conduct onsite inspections when necessary, and budget independence for staffing and resource requirements without seeking prior approval. The mission also encourages that the authority to approve and withdraw licenses (within the constraints of the law) also be included among the powers of INAF. The mission reviewed proposed legislation to increase independence of INAF, through the elimination of the CSF and vesting fewer powers with the Minister of Finance. Functions formerly held by CSF would move to INAF. Uncertain however, is whether INAF will acquire sufficient budgetary independence to provide for its own needs to carry out supervisory responsibilities.
Principle 1(2)	Each such agency should possess operational independence and adequate resources.
Description	INAF is funded by the revenues derived from investment income of a fund provided for by the Andorran Government. The size of the fund is approximately 12 million euros. The present level of revenues derived from the fund can sustain the current level of staffing, but provides little flexibility for an increase as needed to fulfill supervisory responsibilities. To the extent that greater resources are needed, which the mission proposes there will be greater demand on resources, government representatives express that INAF will be able to seek additional funding directly from the government's budget.
Assessment	Largely compliant
Comments	The mission concludes that a deepening of supervisory activity will be necessary to meet the demands of supervision of financial institutions. (See discussion of onsite supervision in BCP 16 and 19.) Particularly, the mission recommends that the INAF develop a capacity to carry out some onsite inspection activity to gain a deeper understanding of the activities of the banks and other financial institutions that it supervises. Moreover, the mission recommends that the supervision of insurance activities be included among INAF's responsibilities. Affects from these recommendations will result in additional demands for budget from other sources. As currently structured, the additional demand for resources would need to be met from the government's budget, through the normal budgeting process as applied to all other functions of government. The mission team considers the assessment of the principle as largely compliant based on statements from government that resources would be available as needed. The mission is not in a position to judge whether with certainty the funding would be available; however, common international practice is for regulatory agencies to be funded by a levy on regulated firms.
Principle 1(3)	A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision.
Description	

	The 1993 *Law regulating the financial system*, and the 1993 INAF law (discussed above in CP 1(1) provide for the oversight functions of banks, specialized credit, and other institutions including investment and fund management companies by INAF, with additional oversight responsibilities assigned to the CSF and Ministry of Finance. Within the financial sector, only the activities of insurance companies presently do not come in under INAF. The 1998 *Law regulating the creation of new banking institutions* (the 1998 Creation Law) establishes requirements for new licenses, vesting with the Finance Minister the final approval on decisions to create or withdrawal banking licenses, based on the recommendation and consent of INAF and the CSF. The range of powers available to INAF is adequate, but as mentioned in 1(1) the mechanisms requiring the complementary actions of CSF and Finance Minister are cumbersome. Existing laws empower the government to set most prudential rules administratively without changes to existing laws. Specific regulations for licensing and ongoing supervision are in place, including the ability to require information from banks in the form and frequency necessary.
Assessment	Largely compliant
Comments	The laws provide generally for the supervision of the financial system, with the exception of insurance. For the larger life insurance companies, they are the subsidiaries of banks, but largely are an activity that is not supervised or not regulated sufficiently, especially given their status as subsidiaries of banks. See BCP 1(1) for discussion of main criticisms regarding legal framework.
Principle 1(4)	A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws, as well as safety and soundness concerns.
Description	There is adequate range of prudential laws and regulations, as well as mechanisms for enforcement powers. Among these are the 1996 *Law regulating rules of solvency and liquidity for financial entities* (1996 Solvency and Liquidity Law) and the 1997 *Law regulating the disciplinary regime for the financial system* (Disciplinary Law). The process for taking enforcement action requires that INAF recommend a disciplinary or enforcement proceeding through the CSF to the Finance Minister; the Finance Minister in turn decides to act on this advice. For the most extreme measure of license revocation, these are powers vested with the Finance Minister on recommendation of INAF and CSF. Other important legislation include the 1998 *Law regulating the basic administrative rules of banking institutions* (Bank Administration Law), which specifies requirements for external auditors, including disciplinary measures that CSF can impose against them. The Solvency and Liquidity Law for financial institutions empower INAF to promote strong capital and liquidity requirements over Andorran financial institutions. Mechanisms for orderly resolution of insolvent institutions would include involvement of INAF. (See BCP 22 for a fuller description of formal powers of supervisor.)
Assessment	Largely compliant
Comments	The law regulating disciplinary rules of the financial system provides the range of powers available to INAF and the CSF to bring about corrective action for non-compliance with laws, regulations. However, the process for action is encumbered by the approval requirements

	imposed by the law that enforcement actions received the prior approval of the CSF/Finance Minister and could affect the ability of INAF to act promptly as may be required.
Principle 1(5)	A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.
Description	Legal protection for INAF employees is provided for through Chapter V of the Administrative Code (articles 58 to 64), passed by law on 13 July 1987. The protections of INAF employees are the same as those available to all officials, civil servants, and agents under employ of the government. Generally, the administration is held liable for the actions of its employees, including INAF employees, when they are acting in an official capacity. In the event of a lawsuit, it would be in almost all circumstances an action taken against the government. In exceptional circumstances, there is the potential that an INAF employee could be personally liable for damages, however exceptional circumstances would need to consider damages caused by the employee due to an action or failure to act for reasons of malice or gross negligence.
Assessment	Compliant
Comments	
Principle 1(6)	Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Description	The sharing of information between INAF, CSF and the Ministry of Finance are clearly established in law. Not specific is whether there are some gateways for communication regarding anti-money laundering.
Assessment	Compliant
Comments	While continuing the assessment of compliance, consideration is warranted to the development of information gateways between the UPB and INAF, particularly to the extent that negative information becomes known that could represent a prudential supervision concern regarding a financial institution under INAF's supervision.
Principle 2.	**Permissible Activities** The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word "bank" in names should be controlled as far as possible.
Description	According to the *1996 Law regulating the operational activities of entities in the financial sector*, the authorized activities considered typical of banking institutions are receiving deposits and other repayable funds from the general public, in the form of demand or time deposits; lending out of their own funds; and offering other financial services, especially those related to payments. In Andorra there is only one type of license for banking institutions. Article 2 of the above noted law defines the term bank and states permissible activities. The law restricts the use of the term bank.
Assessment	Compliant
Comments	

Principle 3.	**Licensing Criteria** The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organization's ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor should be obtained.
Description	The *1998 Law regulating the creation of new banking institutions* establishes requirements for new licenses, vesting with the Finance Minister the final approval on decisions to create or withdraw banking licenses, based on the recommendation of INAF and the CSF. Articles 13 and 14 specify the fit and proper requirements for owners, the requirements for authorization, and information that must be submitted to the Ministry of Finance by applicants. Not required in law, but established in practice, is that the Ministry of Finance relies on the opinion of INAF as to the suitability of applications for new licenses or other application requirements. There are no instances where the decision of the Finance Minister regarding a licensing decision was contrary to the advice of INAF. The Bank Administration Law imposes specific qualification requirements for the general management and the requirement for external audit. The same law imposes allows foreigners to acquire up to 51 percent of the ownership in Andorran banking institutions. To date there are five of eight banks with a controlling stake by Spanish banks. The 1998 *Law regulating the minimum capital requirement for banking institutions* establishes a minimum capitalization requirement equal to Ptas 5 billion or approximately 30 million euros. Criteria for establishment of new financial institutions are consistent with requirements for ongoing supervision. As a procedure for applications by foreign banks, INAF required the prior approval of the home country supervisor.
Assessment	Compliant
Comments	The reliance that the Finance Minister places on INAF for its opinions regarding all decisions on applications is noted. That said, best practice would ensure a more formalized requirement that there be a consent provided by INAF to all applications. The assessment of compliant reflects that in practice, there are not instances where the Finance Minister does not act without receiving the formal opinion of INAF, and there are no instances of where the Minister's decisions were contrary to those of INAF.
Principle 4.	**Ownership** Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.
Description	The Bank Administration Law defines qualified participants in the banks as those owning five percent or more of the capital or voting rights. Changes that affect the holdings of qualified participants that cause holdings to increase above five percent trigger a reporting requirement to INAF. According to Article 18 of the Bank Administration Law, the INAF has the power to deny proposals for changes in control affecting regulated financial institutions.

	Pursuant to the Bank Administration Law, INAF obtains through periodic reporting the names and holdings of shareholders with holdings equal to or greater than five percent.
Assessment	Compliant
Comments	
Principle 5.	**Investment Criteria** Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Description	All investments or acquisitions by Andorran companies, including financial institutions are registered in the Andorran Commercial Registry managed by the Ministry of Economy. INAF has access to the Ministry of Economy registry and is kept abreast of any investment or acquisition made by a financial institution. INAF requires that banks receive approval to make investments, where the investment will exceed 5 percent of the capital of the participated company. Banks' investments are limited to 25 percent of the capital of non-financial companies, and to 40 percent of banks' own capital on the aggregate investments in non-financial companies. Life insurance companies are considered financial companies while non-life insurance is considered a non-financial activity. Financial companies may be acquired in whole. In evaluating investment proposals, INAF applies the criteria in the Administrative Law requiring that investments or acquisitions do not expose the banks to unwarranted risks or impede the discharge of effective supervision INAF's review procedures are adequate for the volume of activity in this area.
Assessment	Compliant
Comments	
Principle 6.	**Capital Adequacy** Banking supervisors must set minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. For internationally active banks, these requirements must not be less than those established in the Basel Capital Accord.
Description	The 1996 Solvency and Liquidity Law requires the maintenance of a minimum 10 percent capital adequacy ratio. The capital adequacy ratio and supporting calculation is reported quarterly to INAF. The calculation of the ratio uses a methodology broadly consistent with the Basle Accord. In addition to credit risk weights, the calculation, and the reporting submitted to INAF includes a market risk charge. The policy also requires the reporting of capital figures on a consolidated basis. The 1997 Disciplinary Law sets the rules under which INAF can take measures to effect correction of unsafe or unsound practices or infractions, including non-compliance with capital adequacy rules. The law grants INAF authority to issue warnings and if conditions are not rectified, INAF can recommend more severe actions such as monetary penalties, and revocation of the banking license to the CSF and Finance Minister.
Assessment	Compliant
Comments	
Principle 7.	**Credit Policies**

	An essential part of any supervisory system is the independent evaluation of a bank's policies, practices, and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolios.
Description	INAF does not perform on-site examinations or as a general practice review banks' loan or investment policies. In practice, INAF relies on the external auditors and particularly on the complementary audit (see BPC-19) to determine whether policies are adequate and whether management and staff adhere to those policies. Thus far, INAF has not specifically made review of credit granting and investment policies part of a core complementary audit requirement. Consequently, external auditors exercise judgment on what policies and to what extent they should be reviewed, which may not always provide INAF with adequate and timely understanding of deficiencies in underwriting and investment practices.
Assessment	Largely compliant
Comments	The mission team recognizes that the bulk of balance sheet assets are high-grade interbank credits to highly rated banks lessening credit risk considerations. Nevertheless, we consider advisable for INAF to foster a strong credit culture by promoting sound credit policies through a core verification requirement in the complementary audit or a periodic, systematic review by INAF staff.
Principle 8.	**Loan Evaluation and Loan-Loss Provisioning** Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices, and procedures for evaluating the quality of assets and the adequacy of loan-loss provisions and reserves.
Description	INAF relies on external auditors to confirm whether banks' evaluation and loan loss provisioning policies and practices meet minimum regulatory requirements. The chart of accounts for the financial system define the classification and provisioning of problem loans. The criteria employed, according to bankers and external auditors, are largely based on policies followed by Spanish supervisors. INAF's policies with respect to the general provisioning for interbank credits are considered conservative at 0.5 percent of net loans as the portfolios are largely deposits to highly rated OECD-based financial institutions. For non-bank credit portfolios, which make up a relatively small part of balance sheets, general and specific provisioning can be lower depending on collateral support and delinquency status. Quarterly reporting on the quality and composition of credit portfolios is adequate and enables INAF to analyze trends in the system.
Assessment	Compliant
Comments	INAF has asked external auditors that this year's complementary audit explain the controls in place to ensure that minimum requirements for specific provisioning are being met for each bank in the system. The mission team considers that such requests from external auditors are advisable and should also ask for conclusions regarding the effectiveness of such controls.
Principle 9.	**Large Exposure Limits** Banking supervisors must be satisfied that banks have management information systems that enable management to identify concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.
Description	Articles 12 and 13 of the 1996 of the Solvency and Liquidity Law require banks to avoid operations comprising risk concentrations. Legal lending limits to the same beneficiary are

	established at 20 percent of bank capital. The law also provides for aggregated concentration limits, which occur when transactions with individual clients exceeding 5 percent reach 400 percent of bank capital. INAF's Comunicat 104 subjects banks to quarterly reporting on concentration limits, including by industry sectors and geographically. External auditors are required to confirm compliance with the law and the Comunicat. Through that validation, they should also be able to determine whether management has put in place adequate management information systems in this area.
Assessment	Largely compliant
Comments	In addition to ensuring compliance with INAF's requirements, INAF should also request the external auditors render a conclusion on whether or not the financial institution has established adequate management information systems to ensure ongoing compliance with concentration limits. This requirement should be explicit in the complementary audit scope.
Principle 10.	**Connected Lending** In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on an arm's-length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.
Description	The chart of accounts of the financial system defines as "connected" all entities that belong to the same economic group, as well as associated companies, multi-group companies and companies in which there is a qualified participation. Qualified participations are instances where the company holds, directly or indirectly, at least 5 percent of the capital or voting rights in the participated company; it designates directly or indirectly at least 20 percent of its members to the Board of Directors; or exerts significant influence over the participated company. In addition, *the 1996 Law regulating the solvency and liquidity criteria* provides a definition of related party transactions as "asset operations made in favor of one and the same family unit and company directly or indirectly linked to the beneficiary or the afore-mentioned other holders by bonds of management or finance, which for the purposes of risk must be considered as forming part of a whole, are considered to be made in favor of one and the same beneficiary." Under Article 15 of the 1996 Solvency and Liquidity Law, financial institutions can not lend or otherwise put at risk more than 15 percent of bank capital to members of its Board of Directors. However, credits to connected or related parties are not required to receive Board of Directors' approval. Further, INAF does not explicitly require that the external audit confirm whether these credits are monitored through an independent credit administration process. Concentration limits discussed on BCP- 9 apply to connected or related parties but there are no other explicit requirements addressing for instance, the extension of credit on more favorable terms (e.g., interest rates, collateral, amortization schedules) than corresponding loans to non-related parties. INAF's requirements include the reporting on shareholders' extensions over 5 percent of capital and credits to other related companies or individuals above 5 percent of capital. Consequently, INAF has the ability to review information on aggregate lending to connected or related parties.
Assessment	Largely compliant
Comments	The mission team considers advisable that INAF expands its policy on credits to insiders and

	related interests as follows: credits to members of the Board of Directors, senior management or their respective related interests should always receive the approval of the Board with due abstention on the part of members benefiting from the transaction; INAF should consider as a core requirement the review of the administration and monitoring of connected credits in the complementary audit with conclusions rendered over whether related credits receive preferential treatment.
Principle 11.	**Country Risk** Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring, and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining appropriate reserves against such risks.
Description	INAF's Comunicat 109 and 122 require financial institutions to provide information regarding on and off-balance sheet items that may be affected by country risk, transactions subject to hedging, and country exposure data for off-site analysis. Detailed bank exposure information by country, region and bank rating is submitted to INAF on a quarterly basis and regularly analyzed.
Assessment	Compliant
Comments	
Principle 12.	**Market Risks** Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor, and adequately control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposure, if warranted.
Description	The most significant factors affecting market risks in most financial institutions are fluctuations in interest rates and foreign exchange rates. Comunicat 104 requires financial institutions to supply detailed information on the character and volume of market risk transactions on a quarterly basis. These reports enable INAF to monitor open positions in futures markets. External auditors review compliance with Comunicat 104 as part of the complementary audit through which they can advise INAF on the adequacy of market risk controls at financial institutions. INAF management has the authority but has not imposed specific market risk limits. This is largely because INAF's monitoring has shown financial institutions continue to comply with internal limits which are not considered excessive. Further, as part of the minimum risk-based capital calculation, financial institutions are required to factor in a 50 percent market risk-weight on futures operations with balances adjusted by maturity and type.
Assessment	Compliant
Comments	We encourage INAF to ensure external auditors convey conclusions on the adequacy of market risk controls on a consistent basis.
Principle 13.	**Other Risks** Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor, and control all other material risks and, where appropriate, to hold capital against these risks.
Description	Under the authority of the Disciplinary Law, INAF has established prudential standards that require financial institutions to limit, monitor, and report on various types of risks including

	credit concentrations, connected lending, credit classification and loan loss provisioning, capital adequacy, liquidity, interest rates, and foreign exchange rates. INAF has the authority to require financial institutions to hold additional capital against material risks. Operating standards, along with the chart of accounts, which requires banks to establish adequate controls to produce reliable accounting data, are relatively new but thus far have enabled the production of adequate data for off-site supervision. INAF actively monitors compliance with risk limitations through quarterly reporting, the accuracy of which is validated by the complementary external audit. (See BCP-19).
Assessment	Largely compliant
Comments	While much progress is evident in recent years, in order to foster a strong risk management culture in financial institutions, the mission team considers advisable for INAF management to: - Ensure that external auditors evaluate policies and practices across functional areas to reach conclusions on the level of adherence to policies and procedures throughout the institution and the extent of oversight, support and direction provided by Boards of Directors, - Expand the frequency and depth of discussions with Boards of Directors regarding the strategic direction and the level of risk tolerance of their institutions to better evaluate the adequacy of risk management programs in light of conclusions reached through external auditor's reports.
Principle 14.	**Internal Control and Audit** Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls, as well as applicable laws and regulations.
Description	There are several internal control components that affect the prudent conduct of business in financial institutions: organizational structures (definitions of duties and responsibilities, discretionary limits for loan approval, and decision-making procedures), accounting procedures (reconciliation of accounts), segregation of duties and independent internal/external audit functions. The 1998 Administrative Law requires that one member of senior management explicitly assume the responsibility for the adequacy of internal controls of a financial institution. The same law requires financial institutions to maintain an organizational structure, internal procedures, and controls meeting high international standards as well as the maintenance of a professional external auditor under contract each year. In order to evaluate the adequacy of internal controls for the nature and scale of their business, INAF routinely requests information on structure, management and employees' qualifications, and staff working in control functions. Further, INAF requires a complementary audit whose scope assists in determining compliance with accounting requirements and the adequacy of procedures supporting the preparation of financial statements.
Assessment	Largely compliant
Comments	To foster a culture of strong internal controls, we encourage INAF to focus on the following areas:

	- Ensure that complementary audits incorporate reviews of internal controls, specifically to cover growing, off-balance sheet activities such as custody services. It is important to assure that bank activities are properly segregated from the banks' own operations and that adequate controls are in place to protect against possible fraud or misappropriation. - Ensure that external auditors test and reach conclusions regarding the independence of the internal audit function and the degree of importance the Board of Directors provides the audit function
Principle 15.	**Money Laundering** Banking supervisors must determine that banks have adequate policies, practices, and procedures in place, including strict "know-your-customer" rules, that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.
Description	According to the 2000 AML Law, the Unitat de Prevenció del Blanqueig (UPB), Andorra's financial intelligence unit is responsible for oversight for the implementation by banks for know-your-customer policies and internal controls, and procedures to prevent susceptibility to criminal elements, particularly money laundering. UPB is empowered by the 2000 AML Law to assess the compliance by banks of the 2000 AML Law requirements. INAF has been divested of a role in this area. The 2000 AML Law requires banks to verify identity through an official government document with a picture, obtain domicile and professional activity information. For legal entities, banks must obtain certification of the registration in the registry of corporations and to obtain identity information from the individuals empowered to represent the entity. Information on beneficial ownership is also required. Customer records must be maintained for a minimum of ten years under the 2000 AML Law. Prior to the 2000 AML Act, the banks were bound by the customer due diligence procedures in the 1995 Law on the Protection of banking secrecy and the prevention of the laundering of money and the proceeds of crime and an agreement developed by the Andorran Bankers Association relating to the obligation for diligence and an operations guide to be used by all bank employees (Code of Conduct) in 1990 to prevent banks from being used as vehicles for money laundering. The banks themselves have internal procedures that far exceed the minimum requirements for customer due diligence. Article 46 of the 2000 AML Law requires suspicious transaction reporting to UPB and UPB is expanding on the law's requirements in a draft Comunicat Technic. The 2000 AML Law requires banks to pay special attention to all operations, which while not suspicious, occur under complex or unusual conditions and do not seem to have an economic justification or legal purpose. The law provides for protection from liability for banks and their employees who provide information to the UPB regardless of whether the information submitted ultimately indicates money laundering. (Article 50). The 2000 AML Law requires banks to maintain internal procedures to recognize suspicious transactions, to appoint a compliance officer (and inform UPB of such appointment), to implement training for all employees and to ensure that the banks have formal procedures to report suspicious activity. (Articles, 46, 47, 48, and 52) All of these requirements are encompassed in the scope of the review by bank external auditors, who are statutorily obliged to provide UPB with a report on compliance with the 2000 AML Law. (Article 48). The UPB primarily relies on the external auditors of the banks to review compliance with the 2000 AML Law and the Comunicat Tecnics issued by UPB. For the year ending 2001, UPB issued a detailed Comunicat Tecnic on the scope of the external audit required and the content

	needed for the reports. UPB has the authority to follow up with the auditors and has drafted internal rules that contemplate a follow up with the auditors. See draft UPB Internal Rules, Article 7.4. UPB has the statutory authority to go onsite and to request any additional information necessary to ensure that banks are following the requirements of the 2000 AML Law. (Article 53). Under Articles 57 through 59 of the 2000 AML Law, UPB has authority to sanction banks for three levels of failures to comply with the law: "very serious," "serious" and "minor" violations. "Very serious violations", are defined as the failure to satisfy the reporting requirement, tipping off, refusal, excuse or resistance to furnishing information to the UPB and repetition of a serious violation in the same year. "Serious violations" are defined as the failure to confirm the identity of clients, failure to demand client identification documents required under Article 51, insufficient verification of the true beneficial owner of a transaction, lack of vigilance and failure to verify identity, failure to retain documents for the 10 period established in Article 51, insufficient internal procedures and failure to carry out the specific audit on AML compliance, and repetition of a minor violation in the same year. "Minor violations" are defined as the failure to inform the UPB of the identity of the compliance officer and any violation of the standards of the Law not mentioned previously. UPB makes recommendations on the violation and the sanction to the Council of Ministers, which administers the sanctions. Sanctions include fines of 600 to 600,000 euros and temporary or permanent suspensions of directors or the person involved, or suspension of the capacity to carry out certain transactions. In addition to its supervisory authority, UPB is empowered to directly share with domestic judicial authorities, INAF, and foreign FIU counterparts information related to suspected or actual criminal activity. Articles 53 and 55. For foreign counterparts the information is provided subject to reciprocity, a commitment to use the information only for the purpose requested, and commitment to maintain professional secrecy. Article 56.
Assessment	Compliant
Comments	The 2000 AML Law provides an adequate framework for UPB to ensure that banks are following policies and procedures required. The reliance on external auditors, given the limited resources of UPB, is sufficient since UPB has the power and the intention to conduct follow up to the external audits. Until the first external audit reports are received in March 2002, the efficacy of the implementation of the reliance on external audit cannot be assessed. To the degree that UPB has provided the external auditors with detailed requirements for the reports, the reports are expected to be comprehensive. Because INAF no longer has a role in this area, certain deficiencies in bank internal controls or management that can impact prudential supervision may come to light during UPB's operations without INAF being aware of the problems. There should be a formal mechanism for ensuring that necessary information is passed between UPB and INAF. A more extensive discussion of anti-money laundering is available in the AML/CFT assessment that took place simultaneously with the BCP review.
Principle 16.	**Onsite and Offsite Supervision** An effective banking supervisory system should consist of some form of both onsite and offsite supervision.
Description	INAF's supervision of the financial sector consists of off-site compilation and analysis of quarterly data submitted by financial institutions in accordance with the chart of accounts; annual onsite external audits pursuant to INAF's complementary audit requirements; annual meetings with bankers and external auditors to discuss developments in the financial institutions

	and the scope of complementary audits; formal comunicat's to convey policies, and other contacts formal and informal with bank managers, directors and bank association leaders during the year to discuss the condition and risks affecting financial institutions. Under the Disciplinary Law, INAF can conduct an on-site examination of a financial institution with the prior approval of the Comite Superior de Finanzas. However, INAF has not conducted its own on-site examinations since its creation in 1989 and has relied on the on-site work of external auditors. INAF required a complementary report of external audit for the first time last year since instituting a new chart of accounts in the year 2000. While the complementary audit requirements need further expansion and standardization (see BCP-19), the audit work has been instrumental in confirming the reliability of quarterly bank data submitted to INAF, and provides an important measure of independent verification on the existence of risk management and internal controls in credit underwriting and evaluation, treasury activities, and off-balance sheet operations. Much has been done to strengthen the supervisory function but significant work remains to strengthen the foundation and move the process forward as noted in the comments section.
Assessment	Largely compliant
Comments	INAF has access to a significant supply of financial data and analysts are producing useful reports that describe the evolving condition of financial institutions and the sector as a whole. To enhance the usefulness of the data and move the supervisory framework along a forward-looking path, the mission team considers that a more in-depth and integrated analysis should be done on the banks and the system. For instance, we recommend that integrated risk assessments taking into account these considerations be prepared semi-annually: - the financial data gathered and analyzed from the quarterly submissions (key factors underpinning the condition of the institution such as capital adequacy, quality of assets and levels of provisioning, quality of earnings and trends, liquidity and asset and liability management, and sensitivity to market risks); - discussions with auditors regarding key conclusions from complementary reviews; - discussions with bankers regarding strategic direction, financial performance and emerging risks; - Andorra's economic conditions and outlook. The assessments should arrive at integrated conclusions over the condition of the institutions, their likely trajectory in the near term, and the principal supervisory concerns to be addressed through further off-site analysis or external audit follow-up.
Principle 17.	**Bank Management Contact** Banking supervisors must have regular contact with bank management and a thorough understanding of the institution's operations.
Description	Comunicat 126/01 calls for INAF, bankers and external auditors to meet annually to discuss the scope of audits, and financial bank performance. While there is no systematic program of meetings, discussions with the bankers' association and individual bankers indicate that in practice, communication between INAF and bankers is fluid and frequent owing to the small number of institutions operating in Andorra and their close proximity to one another.

	INAF management and staff regularly initiate discussions with bankers in connection with their review of the quarterly reports and display good knowledge of banks' management, operations, and performance. During our discussions with bankers, they indicated that their communication with INAF in the recent past has often involved points of clarification with respect to the application of the new chart of accounts, INAF Comunicats setting forth new policies or requesting additional financial information.
Assessment	Compliant
Comments	Although communication channels are active and operational between INAF and the bankers, the mission team considers advisable for INAF to implement a policy of more systematic meetings involving members of Board of Directors, where communication does not seem to be as frequent. The meetings can serve to present major conclusions of off-site analyses, and discuss complementary external audit reports, views on the performance of the financial institutions, and strategic plans and strategies affecting the risk profile of the institutions.
Principle 18.	**Offsite Supervision** Banking supervisors must have a means of collecting, reviewing, and analyzing prudential reports and statistical returns from banks on a solo and consolidated basis.
Description	INAF has the authority to require financial institutions to submit information on their financial condition on a periodic basis, including information on related interests. Article 15 (g) and 16 (h) of the Disciplinary Law provide for penalties for banks failing to provide the information on a timely basis or if they knowingly provide inaccurate or misleading data. INAF requires that financial statement information be submitted quarterly both on an individual and a consolidated basis. The chart of accounts, implemented in 2000, delineates the accounting principles for Andorran financial institutions as well as the reporting requirements. Financial statements may be requested on a solo or consolidated basis. Information on solvency, liquidity, large borrowers, market risks, loan classification and provisioning are submitted on a consolidated basis. The financial information financial institutions submit is used to compile quarterly monitoring reports and statistics which provide detail on the evolution of banks' balance and off-balance sheet activities, earnings performance and movements in capital accounts, asset quality, liquidity and market risk positions, and other useful information on individual institutions as well as the financial sector as a whole.
Assessment	Compliant
Comments	See recommendations on expanding the usefulness of collected data and supervision in BCP 16.
Principle 19.	**Validation of Supervisory Information** Banking supervisors must have a means of independent validation of supervisory information either through onsite examinations or use of external auditors.
Description	Under provisions of Administrative Law, INAF has significant authority over the engagement of external auditors and, they in turn, have a legal duty to inform INAF directly of conditions likely to significantly affect the solvency, liquidity, and stability of a financial institution, should its management fail to do so on a timely basis.

	INAF relies entirely on external auditors for the independent validation of supervisory information received from financial institutions. INAF management meets with external auditors, bank management and internal and external auditors once a year to set the scope of a complementary audit. The report's chief objectives include the certification that banks comply with accounting principles for preparing banks' quarterly financial statements reported to INAF as well as banks' compliance with legal requirements on solvency, liquidity, credit concentrations and connected lending. The scope of the report has appropriately expanded since the initial one completed last year. Significant expansion and the establishment of a set of core activities is highly desirable as suggested in the comments section. The on-site work of the external auditor is pivotal to INAF's ability to rely on financial data, and the management of critical activities and risks within financial institutions. INAF imposes a rotation of external auditors every five years.
Assessment	Largely compliant
Comments	INAF is making progress in effectively using external auditors to support on-site bank supervision. The scope of complementary audits should continue to expand with a comprehensive core set of requirements being established along with the inclusion of further items that have particular importance for individual banks. In addition to the guidance INAF provided for the 2001 complementary report, the mission team recommends consideration of inclusion of the following areas: - Significant events occurring during the period under review, such as key strategic decisions affecting entry to new markets, restructuring of business lines, mergers or acquisitions or other exceptional transactions. - Bank's disaster and recovery plans, including computer system failure - Risk analysis on computer information security, system maintenance and development, operating procedures, and IT technical support - Assessment of adequacy of internal audit, including reliance by external audit - Assessment of credit/counterparty, market, settlement, exchange, interest rate, liquidity, profitability, operational, legal, reputational, and risks relating to asset management services. This should include a qualitative and quantitative analysis reviewing the extent of the risk and controls to identify, monitor, measure and manage it. - Conclusions and indication of sample selection method used in evaluating credits between related parties, including any limitations in fully identifying exposures to all related parties and assurance that Board of Directors has reviewed and approved reports on connected lending -Assessment of credit and investment policies and adherence by management - Resolution of issues raised in previous reports - Overall external auditor's conclusions and key recommendations/observations made to management along with management's responses. - In addition, INAF should ensure that, to the extent possible, the principle of maintaining the same external audit firm for the consolidated financial group is preserved, that all potential conflicts of interest between the external auditor and the bank are fully disclosed, including the

	provision of consulting services.
Principle 20.	**Consolidated Supervision** An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis.
Description	For INAF, consolidated supervision means the ability to review both banking and non-banking activities conducted at the bank, either directly or indirectly (through subsidiaries or affiliates) and activities conducted at both domestic and foreign offices. At present, Andorran banks have no material or active branches or subsidiaries abroad. INAF is well equipped under the Administrative Law to regulate the organizational structure of banking organizations and is empowered to set accounting and reporting standards. As a consequence, INAF has capability to obtain information on a solo and a consolidated basis from banking organizations. Financial institutions are subjected to quarterly reporting on a consolidated basis, enabling INAF to analyze and prepare supervisory reports on the financial system and the banks on a consolidated basis. Insurance companies, whose overall stake in the financial sector are estimated at less than 1 percent, are largely lodged in banks under INAF supervision. To strengthen regulation and give INAF appropriate supervisory authority, the insurance industry should be brought under INAF's oversight.
Assessment	Largely compliant
Comments	While INAF's accounting and reporting requirements facilitate a consolidated view of banking organizations, the mission team stresses further efforts towards a group-wide approach to supervision. Risks emanating from non-banking products or activities conducted through the bank or by affiliates should be identified, and analyzed for their potential effect on the banking organization. Consequently, as INAF has started to do through the complementary audit, we encourage INAF to ascertain the appropriateness of banks' consolidation practices, and ensure that risk management systems at investment firms are adequate. In order to strengthen INAF's ability to perform more effective, consolidated supervision over insurance companies affiliated with banks and strengthen the regulation of the insurance industry as a whole, the mission team considers it advisable to bring the insurance services industry under the oversight of INAF. This implies the need for an appropriate legal and physical structure, in terms of resources and expertise for INAF in order to effectively discharge new responsibilities. The current size and volume of the industry should not result in a heavy burden INAF's supervisory resources.
Principle 21.	**Accounting Standards** Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business, and that the bank publishes on a regular basis financial statements that fairly reflect its condition.
Description	Beginning in 2000, INAF introduced a standardized chart of accounts for the financial system. The chart of accounts was applied for end-2000 and subsequent reporting periods. The chart of accounts has improved the quality of the reporting requirements for Andorran financial institutions. The chart of accounts and subsequent communications from INAF relating to the presentation of financial information does not differ significantly from International Accounting Standards

	established by the International Accounting Standards Committee. Valuation rules are consistent and reflect appropriate prudence. Article 4 of the Disciplinary Law allows INAF to establish the scope and standards to be achieved in external audits. INAF relies on the work of external auditors to verify the accuracy of financial and managerial reporting to INAF. The auditors are required to test the accuracy of all reporting over the calendar year. Pursuant to Article 18 of the Administrative Law, INAF can recommend that the auditor's appointment be revoked in instances of serious infraction. (see BCP 22 for further discussion of actions against auditors.) INAF meets regularly with external auditors to discuss preparation of audit activities and findings. As noted in the discussion of BCP 16 and 19, INAF relies extensively on the work of external auditors to carry out the onsite supervision role. The primary tool for accomplishing this work is the completion of the complementary report. The complementary report provides specific guidance to auditors as to areas that must be reviewed on behalf of INAF.
Assessment	Compliant
Comments	The adequacy of financial reporting is of high quality, and the process of implementing the complementary audits is evolving well. BCP 16 and BCP 19 make recommendations on how the complementary report can be improved upon for purposes of carrying out the onsite supervision requirements for INAF.
Principle 22.	**Remedial Measures** Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking license or recommend its revocation.
Description	As stated above in BCP 1(4), there is adequate range of prudential laws and regulations, as well as mechanisms for enforcement powers. The 1997 Disciplinary Law establishes two types of disciplinary proceedings, these are (i) administrative/corrective orders imposed on institutions, and (ii) financial penalties and sanctions against individuals and institutions for infractions. Financial penalties come in three levels depending on severity of infraction. The penalties provide for a ladder of compliance that sets out types of timely and appropriate action to be taken in defined circumstances. The Disciplinary Law provides the range of powers available to INAF and the CSF to bring about corrective action for non-compliance with laws, regulations. The Solvency and Liquidity Law for financial institutions empower INAF to promote strong capital and liquidity requirements over Andorran financial institutions. Mechanisms for orderly resolution of insolvent institutions would include involvement of INAF. As note in BCP 1, the process for introducing penalties is cumbersome, as it requires the recommendation by INAF to the CSF and/or the Finance Minister. For the most extreme measure of license revocation, these are powers vested with the Finance Minister on recommendation of INAF and CSF. Other important legislation include the Bank Administration Law, which specifies requirements for external auditors, including disciplinary measures that CSF can impose against them. Article 10, defines the obligations of the auditor and the possible sanctions for not complying with the law. External auditors have a duty to report instances where they become aware of the existence of suspicious facts or incidents, which could gravely affect the solvency, liquidity,

	and the stability of the banking institutions. Non-compliance could expose auditors to fines up to approximately euros 150,000 and suspension from being able to work in Andorra for up to five years or permanently depending on severity of the infraction. In the past two years, there have been no cases involving penalties to auditors. Pursuant to Article 12 of the Disciplinary Law, INAF may recommend to the CSF enforcement and/or corrective measures over financial institutions, and individuals affiliated with regulated financial institutions, including employees, the management, boards of directors, etc. The most severe power under the Disciplinary Law, is the ability to revoke the banking license, which can only be taken with the authorization of the Finance Minister. In advance of any decision to revoke a banking license, the Finance Minister would first consider the views of INAF and the CSF.
Assessment	Compliant
Comments	Earlier for BCP 1(4) we provided a largely compliant rating. That less than compliant rating reflected the constrained nature of the legal framework for authorizing enforcement actions. The same criticism is not presented here. The assessment of compliance is based on the adequacy of type and range of enforcement actions that can be applied both against individuals and institutions.
Principle 23.	**Globally Consolidated Supervision** Banking supervisors must practice global consolidated supervision over their internationally active banking organizations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organizations worldwide, primarily at their foreign branches, joint ventures, and subsidiaries.
Description	The foreign activities of Andorran financial institutions are extremely limited, as presently there is only a single foreign subsidiary and no foreign branches. The activities of the subsidiary are included in the consolidated accounts of the Andorran financial institution and appear to be of limited consequence to the consolidated organization. Banking entities must inform INAF on changes in the qualified participations in foreign companies. To the extent that a participation has a significant negative effect because of managerial or financial factors, INAF has the ability to prevent the participation under Article 18 of the 1998 Bank Administration Law.
Assessment	Compliant
Comments	
Principle 24.	**Host Country Supervision** A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.
Description	Because there are no instances of significant overseas branches or subsidiaries of Andorran banks, there is not a need for information exchange with the foreign host supervisory authority.
Assessment	Not applicable
Comments	
Principle 25.	**Supervision Over Foreign Banks' Establishments** Banking supervisors must require the local operations of foreign banks to be conducted with the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of

	carrying out consolidated supervision.
Description	Banks from Spain control five of eight Andorran banks. For these institutions, there is highly restricted access to supervisory and other prudential information by the home country supervisor, the Bank of Spain. The Bank of Spain is not allowed to conduct onsite inspections or visits to the Andorran subsidiaries, which effectively limits the ability of the home country supervisor to carry out consolidated supervision. In the only recent instance of a new entrant into Andorra by a foreign bank, INAF wrote and received a non-objection from the home-country supervisor prior to granting a banking license.
Assessment	Materially non-compliant
Comments	To the extent that INAF has limited resource capacity to conduct onsite inspections, and the use of external auditors for onsite supervision is not well developed, there is not yet an adequate process whereby the home country supervisor can confidently rely on the supervision carried out by INAF. The restrictions on the ability of the foreign supervisor (i.e., Bank of Spain) to inspect onsite the activities of subsidiaries impose a restriction that impedes consolidated supervision. Pending efforts to modify legislation to allow INAF to enter into arrangements with foreign supervisors will help to facilitate consolidated supervision. In addition greater capacity building is needed for onsite/offsite supervision (see BCP 16) by INAF, including deepening of the work for external auditors, as well as the building of a credible capacity to carry out onsite inspections. The strengthened capacity within INAF would allow the home country supervisor to have greater level of assurance regarding the adequacy of supervision of subsidiaries in Andorra. Pending legislation will afford greater independence on INAF to enter into supervisory arrangements with foreign supervisors, which is encouraged. Moreover, the communication between the host supervisor (i.e., INAF) and the home supervisor (i.e., Bank of Spain) would be aided through bilateral meetings at a frequency of at least once every other year, of as often as necessary for Bank of Spain.

Table 3. Summary Compliance with the Basel Core Principles

Core Principle	C[1/]	LC[2/]	MNC[3/]	NC[4/]	NA[5/]
1. Objectives, Autonomy, Powers, and Resources					
1.1 Responsibilities and objectives			X		
1.2 Operational independence		X			
1.3 Legal framework		X			
1.4 Enforcement powers		X			
1.5 Legal protection	X				
1.6 Information sharing	X				
2. Permissible Activities	X				
3. Licensing Criteria	X				
4. Ownership	X				
5. Investment Criteria	X				
6. Capital Adequacy	X				
7. Credit Policies		X			
8. Loan Evaluation and Loan-Loss Provisioning	X				
9. Large Exposure Limits		X			
10. Connected Lending		X			
11. Country Risk	X				
12. Market Risks	X				
13. Other Risks		X			
14. Internal Control and Audit		X			
15. Money Laundering	X				
16. Onsite and Offsite Supervision		X			
17. Bank Management Contact		X			
18. Offsite Supervision		X			
19. Validation of Supervisory Information		X			
20. Consolidated Supervision		X			
21. Accounting Standards	X				
22. Remedial Measures	X				
23. Globally Consolidated Supervision	X				
24. Host Country Supervision					X
25. Supervision Over Foreign Banks' Establishments			X		

[1/] C: Compliant.
[2/] LC: Largely compliant.
[3/] MNC: Materially non-compliant.
[4/] NC: Non-compliant.
[5/] NA: Not applicable.

Recommended action plan and authorities' response to the assessment

Recommended action plan

Table 4. Recommended Action Plan to Improve Compliance of the Basel Core Principles

Reference Principle	Recommended Action
1(1). An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks	The INAF should have authority to determine applicable regulation and supervisory policies within the constraints of the law. These should include the ability to contract and direct the work of external auditor's complementary onsite work; conduct onsite inspections when necessary, and budget independence for staffing and resource requirements without seeking prior approval. The mission also encourages that the authority to approve licensing decisions (within the constraints of the law) also be included among the powers of INAF.
1(2). Each such agency should possess operational independence and adequate resources	The mission recommends that the INAF develop a capacity to carry out some onsite inspection activity to gain a deeper understanding of the activities of the banks and other financial institutions that it supervises. Caution is warranted against adding functions to INAF that are not compatible with its financial sector supervisory role. The supervision of insurance activities should be included among INAF's responsibilities.
1(4). A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws, as well as safety and soundness concerns	Remove the prior approval encumbrances that could affect the ability of INAF to act promptly as may be required in an enforcement action.
3. Licensing Criteria	Best practice would ensure a more formalized requirement that INAF provide its formal consent to all applications. [There is confusion as to the authorization powers of INAF with regard to the establishment of foreign subsidiaries of Andorran banks. In an opinion provided by INAF to an Andorran bank, the authorization by INAF to expand abroad is not a requirement under current law.]

Reference Principle	Recommended Action
7. Credit policies	INAF should foster a strong credit culture by promoting sound credit policies through a core verification requirement in the complementary audit or a periodic, systematic review by INAF staff.
8. Loan Evaluation and Provisioning	Request external auditors to render judgments over loan loss provisioning.
9. Large Exposure Limits	INAF should request the external auditors render a conclusion on whether or not the financial institution has established adequate management information systems to ensure ongoing compliance with concentration limits. This requirement should be explicit in the complementary audit scope.
10. Connected Lending	INAF should expand its policy on credits to insiders and related interests as follows: credits to members of the Board of Directors, senior management or their respective related interests should always receive the approval of the Board with due abstention on the part of members benefiting from the transaction; INAF should consider as a core requirement the review of the administration and monitoring of connected credits in the complementary audit with conclusions rendered over whether related credits receive preferential treatment.
13. Other Risks	Ensure that external auditors evaluate policies and practices across functional areas to reach conclusions on the level of adherence to policies and procedures throughout the institution and the extent of oversight, support and direction provided by Boards of Directors. Expand the frequency and depth of discussions with Boards of Directors regarding the strategic direction and the level of risk tolerance of their institutions to better evaluate the adequacy of risk management programs in light of conclusions reached through external auditor's reports.

Reference Principle	Recommended Action
14. Internal Control and Audit	Ensure that complementary audits incorporate reviews of internal controls, specifically to cover growing, off-balance sheet activities such as custody services. It is important to assure that bank activities are properly segregated from the banks' own operations and that adequate controls are in place to protect against possible fraud or misappropriation. Ensure that external auditors test and reach conclusions regarding the independence of the internal audit function and the degree of importance the Board of Directors provides the audit function.
15. Money Laundering	There should be a formal mechanism for ensuring that necessary information is passed between UPB and INAF.
16. Onsite and Off-site Supervision	A more in-depth and integrated analysis should be done on the banks and the system. The assessments should arrive at integrated conclusions over the condition of the institutions, their likely trajectory in the near term, and the principal supervisory concerns to be addressed through further off-site analysis or external audit follow-up. The mission further recommends that INAF develop a capacity to conduct onsite inspections.
19. Validation of Supervisory Information	The scope of complementary audits should continue to expand with a comprehensive core set of requirements being established. INAF should ensure that, to the extent possible, the principle of maintaining the same external audit firm for the consolidated financial group is preserved, that all potential conflicts of interest between the external auditor and the bank are fully disclosed, including the provision of consulting services, and that banks comply with guidelines on the 5-year rotation of external auditors.

Reference Principle	Recommended Action
20. Consolidated Supervision	The mission team stresses further efforts towards a group-wide approach to supervision. Risks emanating from non-banking products or activities conducted through the bank or by affiliates should be identified, rolled-up and analyzed for their potential effect on the banking organization In order to strengthen INAF's ability to perform more effective, consolidated supervision over insurance companies affiliated with banks and strengthen the regulation of the insurance industry as a whole, the mission team considers it advisable to bring the insurance services industry under the oversight of INAF.
25. Supervision over Foreign Banks' Establishments	Pending efforts to modify legislation to allow INAF to enter into arrangements with foreign supervisors will help to facilitate consolidated supervision. In addition greater capacity building is needed for onsite/offsite supervision (see BCP 16) by INAF, including deepening of the work for external auditors, as well as the building of a credible capacity to carry out onsite inspections. The strengthened capacity within INAF would allow the home country supervisor to have greater level of assurance regarding the adequacy of supervision of subsidiaries in Andorra.

Authorities' response to the assessment

The Ministry of Finance is grateful to the International Monetary Fund for having agreed, at the request of the Andorran authorities and in accordance with the letter sent to the Fund on 5 September 2001, to make an assessment of the Andorran financial system on the basis of module 2 of the Fund assessment programme. The Ministry especially wishes to thank the evaluation team, made up of Mr. Michael Moore (Monetary and Exchange Affairs Department, IMF), who led the assessment, Ms. Moni Sengupta (the Legal Department, IMF), Mr. Saul Carpio, (banking supervision expert from the US Comptroller of the Currency, USA), Ms. Marie-Christine Dupuis (anti-money laundering expert from the United Nations Global Program against Money Laundering, Austria) and Mr. Guillaume Leroy (insurance consultant, France), for their dedication and professionalism in the work of assessment.

Although Andorra is not currently a member of the IMF, it has been co-operating with it since 1996 and shares its expressed interest in protecting global financial stability and giving

its cross-border financial exchanges greater transparency. This is why the Andorran government, in a spirit of co-operation and decision, has not hesitated to take part in the IMF's initiative in order to demonstrate the compliance of its financial system with international regulations and the standards of the various international bodies and at the same time to improve the system of supervision and regulation of the financial system in constant development. At the same time, the Andorran authorities have also agreed to carry out, as the second part of the programme, the assessment of the system of anti-money laundering and combating the financing of terrorism.

With regard to the recommendations made by the Fund, these have been welcomed with acceptance and interest, and in fact the Andorran authorities are already working on their effective implementation. It must be considered that a large part of the recommendations made are related to the legal framework regulating the functions, competence and structure of INAF, which is being redefined in the form of a new project of Act for the Andorran National Institute of Finance. The objective of the project of Act is to consolidate INAF as an executive technical organ of the financial authority of the Principality of Andorra, with a redefinition of its competence in order to give INAF greater autonomy and, in general, to bring its powers onto a level with those of supervisory institutions in other countries. Specifically, the increase in the powers of INAF will give it competence for sanctions and increase its field of action, enabling it to undertake autonomous actions such as *in situ* inspections, substitution of government organs and the determination of preventive measures. At the same time, the increase in the competence of INAF will be accompanied by the adoption of functional measures to guarantee its independence, and the redefinition of its operative structure. This will include, principally, the remodelling of the organs of Government of INAF and the abolition of the Consultative Committee. On the other hand, increasing the competence of INAF involves a change in the architecture of the supervisory system, with the abolition of the Higher Finance Committee as the highest authority of the financial system, in the light of the competence vacuum provoked by the concentration of these in the INAF organs of Government, and the transfer of control and supervision of the legislation on anti-money laundering to the money laundering prevention unit, UPB (the Andorran Financial Intelligence Unit)

In relation to the system of supervision of insurance companies, the Ministry of Finance envisages preparing, during the course of this year, a project of Act with the purpose of updating the legal regime of regulation of the operational powers of insurance companies, in conformity with international principles in these matters. Thus, and following the recommendations made, the insurance sector will have to be integrated into the financial system and come under the supervisory authority of INAF.

With regard to the supervision in a consolidated basis of institutions in the financial system with a majority foreign participation, the amendment of the legislation governing INAF and the increase in its independence and functions must allow an increase in cooperation with foreign supervisory organisations and promote the establishment of protocols or action agreements so as to guarantee an effective level of supervision.

Finally, with the development of this initiative (completely voluntary), the Ministry of Finance will have available an objective report which will evaluate fairly the attainment by the Andorran banking system of international principles which bring out the efficiency and security of Andorran banking. At the same time it is expected that the Fund's assessment will allow Andorra to be considered as not being an offshore financial centre, which carries with it an inherent risk in the world context, and will serve as a basis not to figure on the list of those financial centres with a significant amount of offshore activities and with insufficient regulation of their financial systems.

IV. Assessment of the Legal, Institutional and Supervisory Aspects for Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)

A. Summary

Summary Assessment

42. This Mission assessed Andorra's efforts in anti-money laundering and combating the financing of terrorism ("AML/CFT") using the Fund and Bank Methodology for Assessing Legal, Institutional, and Supervisory Aspects of Anti-Money Laundering (the "AML/CFT Methodology").[8]

43. The Mission finds that Andorra has a satisfactory legal and institutional framework for preventing and detecting money laundering in the financial sector. Andorra has made substantial progress with the recommendations received from both (i) Council of Europe's Select Committee of Experts (PC-R-EV) in June 1999 (which included two representatives of the Financial Action Task Force (FATF)) and (ii) Arthur Andersen in March 2000.[9] The enactment of *the Law on International Criminal Cooperation and Combating the Laundering of Money or Valuables Resulting from International Crime* on December 29, 2000, (the 2000 AML Law) substantially enhanced the anti-money laundering framework. The creation and the operations of the Unitat de Prevenció del Blanqueig (UPB)—which is Andorra's Financial Intelligence Unit—have added an important component to the capacity to combat money laundering and the financing of terrorism. These efforts demonstrate that the Andorran government clearly has the political will to ensure strong anti-money laundering measures are in place for the entire Andorran economy, for financial and non-financial activities. Certain assessment criteria are rated as largely compliant rather than compliant because the implementation of the law has not been completed, for example, the assessment

[8] For the review of anti-money laundering, the mission observed the guidance in the draft AML/CFT methodology document that was issued to the IMF's Executive Board on February 7, 2002 (SM/02/40).

[9] The Arthur Andersen review was commissioned by the government of Andorra.

team is not able to review the effectiveness of the external audit reports, the first of which are not due until March 30, 2002, although previous external audit reports under the 1995 Law were required to include a specific section concerning the adequacy and compliance with the 1995 Law requirements for AML.

44. Furthermore, the Mission reviewed the supervision and monitoring of regulations in the banking sector and has found that the law, regulations, and supervisory measures meet generally accepted standards for deterrence to minimize the susceptibility of the banks in Andorra as vehicles for money laundering and the financing of terrorism.[10] Banks themselves have well-established and accepted practices for preventing and detecting money laundering. On the whole, the Mission finds that Andorran government officials, the banking sector and the banks' external auditors have a heightened awareness of potential susceptibility to money laundering and are committed to minimizing such potential within Andorra. In this regard, the Mission finds that the government and the financial sector are operating in unison to ensure that the Andorran financial sector is not used for money laundering.

Recommendations

45. The mission proposes a limited number of recommendations that will allow for a more thorough and consistent application of the 2000 AML Law and will promote efficient monitoring of compliance measures.

- Consideration of changes to Andorran law including ensuring that upcoming revisions to the Penal Code expand the list of predicate crimes to include all serious crimes consistent with the Palermo Convention, addressing the rights of *bona fide* third parties in confiscation procedures, providing for confidentiality of UPB records and internal operations, and assessing the scope of Constitutional protections from suit afforded to UPB members.

- Policy and organizational adjustments that include assessing whether UPB resources will need to be adjusted in order to carry out its statutory duties, providing a formal mechanism for communication between UPB and INAF to ensure that any prudential issues discovered by UPB are promptly communicated to INAF, and assessing necessary adjustments to the suspicious transaction reporting mechanism after a period of implementation and as the number of reports increases.

- Potential adjustments to the external audit process and reports including a formalized requirement to ensure that UPB receives audit reports that are unedited or unmodified by the banks, consideration of preparatory meetings between the external auditors and

[10] The standards assessed broadly are the Financial Action Task Force Forty Recommendations against money laundering and the eight special recommendations to combat the financing of terrorism.

UPB prior to the preparation of reports, a more formalized procedure for follow up to the external audit reports submitted, and conducting an evaluation of the external audit report procedure to make necessary adjustments for future external audits.

- Specifically with respect to the banking sector, some consideration should be given to requiring the auditors to conduct a sample testing of numbered accounts for compliance with the 2000 AML Law and the external auditors should be charged with reviewing that banks are applying fit-and-proper tests. As part of proposed legislation addressing the banking sector, the law should subject all employees of banks to fit-and-proper requirements and require banks to screen new employees for criminal records. UPB should consider providing the banks with some additional guidance on how to handle customer inquiries when an account is blocked by UPB.

B. Detailed Assessment

Information and methodology used for the assessment

46. The Andorran anti-money laundering system was assessed for compliance with the criteria described in the AML/CFT methodology for assessment of the legal and institutional framework and financial supervisory principles in the prevention of money laundering and combating the financing of terrorism. The assessment is based on a review of the legislation, regulations of UPB, and interviews with staff of the Ministry of Finance (MOF), UPB, the Ministry of Foreign Affairs, the Ministry of Interior and Justice, the Director of Police, members of the judiciary, three of Andorra's six banks, and the Association of Andorran Banks (ABA). The mission also met with KPMG and Arthur Andersen, which both conduct prudential and AML/CFT audits for banks in Andorra.

47. The staff of the MOF and UPB were very helpful, agreeing to the mission's requests for multiple meetings as well as organizing meetings with the other government officials and private bodies. The mission appreciated the quick responses to the assessors' requests for additional information and statistics needed to complete this assessment. Prior to and during the mission, the MOF provided the assessors with numerous resource documents, including responses to the United Nations Resolution 1373 concerning the self-assessment on the 8 special recommendations of FATF on the financing of terrorism, and a completed questionnaire for the Egmont Group. The assessment team also reviewed operational and draft procedures of UPB.

48. The mission reviewed a previous assessment conducted by PC-R-EV. Their *First Evaluation Report on the Principality of Andorra*, adopted in June of 1999, was generally favorable, describing the Andorran anti-money laundering regime as resting "on sound bases from both the criminal law and regulatory standpoints." The PC-R-EV proposed specific legal revisions to enhance the Andorran anti-money laundering regime. To follow up on the PC-R-EV Report, the government engaged Arthur Andersen to make recommendations. Arthur Andersen in March 2000 delivered to the Andorran National Institute of Finance (INAF) a detailed *Report on Prevention of Money Laundering in Andorra*, which included a

broad range of legislative recommendations. A substantial number of these recommendations were adopted by the enactment of the 2000 AML Law. This mission has paid special attention to the points raised in the PC-R-EV and Arthur Andersen reports in assessing the legal and regulatory framework of the 2000 AML Law.

Legislative and regulatory framework

49. Andorra's legal framework in anti-money laundering and combating the financing of terrorism is largely contained in the 2000 AML Law, which became effective June 2001 and in the Andorran Penal Code. The 2000 AML Law is based in large part on Andorra's ratification of 1988 Vienna Convention, the European Convention on Laundering, Search, Seizure, and Confiscation of the Proceeds of Crime (the Strasbourg Convention) and the European Convention on Mutual Assistance in Criminal Matters and Extradition. The 2000 AML Law provides for formalized international mutual cooperation on criminal matters, creates and empowers UPB with exclusive jurisdiction over money laundering investigations and supervision, provides comprehensive customer due diligence and recordkeeping requirements for financial intermediaries, and provides detailed suspicious transaction reporting requirements. Andorra signed the United Nations Convention for the Suppression of the Financing of Terrorism on November 10, 2001 and the United Nations Convention on Transnational Organized Crime (the Palermo Convention) on November 12, 2001. Accordingly, UPB's mandate now also includes combating the financing of terrorism.

50. The 2000 AML Law replaced the May 1995 Law on the protection of banking secrecy and the prevention of the laundering of money and the proceeds of crime (the 1995 Law). The 2000 AML Law completes a robust organizational system for preventing money laundering in Andorra, which now addresses AML/CFT at the statutory, supervisory, and institutional best practices levels. Substantive changes to Andorra's anti-money laundering framework include vesting supervisory authority for AML/CFT exclusively with UPB. Moreover, the 2000 AML Law provides greater clarity and guidance on monitoring for and reporting suspicious activity and triggers reporting at a lower threshold than previously, moving from a strong suspicion of actual money laundering to a reporting when any operation or transaction raises suspicions of laundering even if the operation ultimately does not result in a finding of money laundering. For the first time, financial institutions and their employees are insulated from liability for disclosure of suspicious transactions to UPB. Andorran officials, including the MOF, UPB and the judiciary have already shown a commitment to ensuring that the full scope of the 2000 AML Law is operational.

51. Andorra criminalized money laundering in 1990 and broadened the scope of money laundering crimes in 1995. The money laundering offenses cover any act to conceal the origin of the proceeds of crime, including action that a person should have known the origin of the funds, aggravated laundering with the intent to derive a profit or as part of an association formed to commit offenses or launder money stemming from offenses committed abroad, and negligent, imprudent or incompetent acts that have resulted in money laundering. The Andorran Penal Code also separately criminalizes terrorism offenses, including the financing of terrorism and providing lodging or refuge for terrorists, among other offenses.

The Andorran Parliament has assembled a working group to revise the Penal Code to reflect Andorra's obligations under international conventions. After September 11, 2001, UPB issued a directive to all banks requesting they investigate the names provided on the FBI list of entities and individuals connected with the hijackers and UPB conducted a separate investigation. No assets connected with the names provided were located in Andorra.

52. Prior to the adoption of the above-specified additions to the Penal Code, in 1990 the ABA developed an agreement relating to the obligation for diligence and an operations guide to be used by all bank employees (Code of Conduct) in 1990 to prevent banks from being used as vehicles for money laundering. All Andorran banks (which together constitute virtually the entire Andorran financial system) signed an agreement to follow the Code of Conduct. The Code includes basic elements for the prevention of money laundering, including, e.g., know-your-customer rules (including verification of ultimate beneficial owners of accounts and origins of funds), retention of records and documents for five years, prohibition on assisting customers in laundering, and cooperating with legal authorities. The Code became the backbone of the banks' internal anti-money laundering policies and procedures. The Code was largely incorporated into the 2000 AML Act and the ABA anticipates updating the Code of Conduct by end-2002 to include ethical standards of professional conduct in banking activity that will also apply to AML..

53. The 1995 Law essentially enacted the elements of the Code of Conduct concerning know-your-customer and retention of records and provided for suspicious transaction reporting for the first time. As a result of the 1990 Code of Conduct and the 1995 Law, the Andorran banks have had strong AML procedures and controls for a number of years, including internal record retention policies that greatly exceeded the five-year requirement. Thus, after enactment of the 2000 AML Law, the banks had few adjustments to make to their internal policies to ensure compliance. Nevertheless, the banks appear to have thoroughly reviewed their internal policies and procedures after the 2000 AML Law went into effect and at least one has had their external auditor conduct a special audit on the adequacy of its policies and internal controls. To enhance their procedures the banks have had audit firms develop software systems for client due diligence and detecting unusual, suspicious, and complex transactions. Training has been systemized and before the 2000 AML Law was enacted the ABA conducted a three-module training program that approximately 80% of bank employees attended. Each bank has since conducted its own internal training program.

Organizational framework

54. The 2000 AML Law imposes anti-money laundering compliance on a broad range of financial intermediaries, including operating institutions of the Andorran financial system (banks and wealth management institutions), insurance and reinsurance companies, as well as other individuals or legal entities that, in the exercise of their profession or corporate activity, carry out, control, or advise on operations involving movements of money or valuables that could be susceptible to being used for money laundering. Also specifically included are outside accountants and tax advisers, real estate agents, notaries, members of other independent legal professions (when they participate in enumerated commercial or financial

activities), and vendors of highly valuable items such as precious stones and metals, when payment is made in cash and for amounts equal to or more than 15,000 euros.

55. The 2000 AML Law vests specific government officials with a role in Andorra's anti-money laundering effort. UPB is responsible for AML/CFT compliance, suspicious transaction reporting and providing assistance to counterpart FIUs. The 2000 AML Law vests exclusive supervisory power in anti-money laundering with UPB and eliminates the role of INAF and the Supreme Commission of Finance (CSF) in AML/CFT. The Tribunal of Judges (*Battles*), and the Attorney General (*Ministeri Fiscal*) are responsible for responding to international requests for judicial assistance, and the Ministry of Foreign Affairs is responsible for transmitting and returning international requests for mutual assistance arriving through diplomatic channel. The Criminal Court (*Tribunal de Corts*) is responsible for criminal matters. The MOF does not maintain a direct role in AML/CFT supervision but provides input on the proposals by the government, including changes in the legal framework. The MOF and the Minister of Interior and Justice are currently reviewing the draft Internal Rules of UPB, and will provide comments on, which is expected to be published in the official government journal in March 2002. The Internal Rules were finalized on March 27, 2002, and published in the Andorran Official journal.

56. After the 2000 AML Law, AML/CFT customer due diligence, recordkeeping and suspicious transaction reporting are no longer limited to banks but apply to the entire list of entities that are subject to the law, as detailed above. UPB is working with professional associations for real estate and investment companies for training in 2002. Besides banks, Andorra has a small number of specialized financial institutions, including wealth management institutions, financial institutions managing investment organizations and installment sales financing. Andorra also has insurance firms. Several of these entities are affiliated with Andorran banks, and therefore, are already subject to prudential supervision, however, Andorra does not prudentially supervise these entities separately. These entities comprise a relatively small percentage of the Andorran financial activity. AML/CFT compliance for all these entities is vested with UPB so the AML team has not assessed for Part 2 modules pertaining to insurance or capital markets sectors separately. Similarly, this assessment does not assess Part 3 for other financial services providers separately. The legal and institutional aspects that are applicable to these sectors are addressed in detail in Part 1.

57. The assessment team notes, however, that while the institutional framework is in place to impose the anti-money laundering requirements to banks and other parts of the financial sector the implementation of the framework has yet to be assessed. The banks are aware that their auditors must prepare a special audit report on compliance with the 2000 AML Law and the auditors will be completing the first reports for UPB on March 30, 2002. A full picture of the implementation at the bank level should be understood after the reports are submitted. It is unclear, however, whether other parts of the financial sector or the insurance sector understand this obligation and whether the implementation of the audit requirement as to these entities will be fully implemented this year. For subject entities such as insurance, real estate, and vendors of high value goods, effective implementation of the special audit to UPB is likely to lag behind the banks until UPB has had an opportunity to conduct training for these entities.

Ensuring full implementation may require additional resources for UPB necessitating that UPB staff be increased to the statutory maximum of five persons.

Part 1: Assessing the AML/CFT in the legal and institutional framework

Table 5. Detailed Assessment of the Legal and Institutional Arrangements for AML/CFT

Legal requirements for supervision and regulation ***Client Due Diligence*** Financial intermediaries[11] should be required to verify the identity of customers, to keep records of financial transactions, and to report unusual or suspicious transactions to a competent authority	
Description	The 2000 AML Law emphasizes the *know-your-customer* rules in accordance with the FATF's 40 Recommendations, and carries the diligence beyond financial institutions into non-financial fields. Article 51 requires subject entities of the financial system to identify clients, either occasional or usual, at the time "any commercial relationship is established" through "presentation of an official document." Article 45 specifically includes as subject entities operating entities of the Andorran financial system. Article 44 specifies that branches, affiliate or delegations of Andorran corporations located overseas, and corporations that are domiciled overseas and whose control is in the hands of individuals or legal entities that are Andorran citizens or residents of Andorra, whose purpose is commercial or financial operations are covered. When the local legislation is in conflict with the application of the legislative principles established in Andorra, Article 11.2 of UPB draft Internal Rules require notice to UPB and authorizes UPB to inform the relevant Andorran authority for appropriate action. As stated above, Article 45 applies the 2000 AML Law to a broad scope of non-financial entities that in the exercise of their profession or corporate activity, carry out, control or advise on operations involving movements of money or valuables that could be susceptible of being used for money laundering, such as "1- outside accountants and tax advisors; 2- real estate agents; 3- notaries and members of other independent legal professions when they participate in certain enumerated activities that involve financial or commercial transactions. Dealers of high value goods such as precious stones and metals when payment is made in cash and for amounts above 15,000 euros are subject to the law. Foreign exchange houses and money remittance or transfer companies do not exist in Andorra and currency exchange and money transfer operations are performed by the banking

[11]Financial institutions (including banks, insurance companies, broker-dealers, trust companies), foreign exchange houses, and money remittance/transfer companies (whether formal or informal), and, depending on a risk-based analysis, other persons who engage, other than on an occasional basis, in financial activities (see Annex II to FATF Recommendation 9) on behalf of clients or customers (including fund managers, attorneys, and accountants) and eligible introducers. Also, again depending on a risk-based analysis, other persons that regularly engaged in the sale of high value items or who otherwise handle large sums of cash (e.g., casinos, real estate brokers, precious gold or metal dealers, antique dealers) may also be treated as financial intermediaries for purpose of some or all of the customer due diligence criteria.

	institutions. Article 51.c.1 of the 2000 AML Law requires that proof of identity be established by an official document bearing a photograph, domicile and professional activity. For a legal entity, supporting documentation is comprised of certification of their registration in the Registry or Corporations and demonstration of the identity of the individual who is empowered to represent the entity (Article 51.c.2). Further details for client identification are specified in the Internal Rules under Article 3, specifying that if the client is a legally constituted body, the required documentation must comprise a copy of the certificate of its entry in the company register and of the license to carry out a commercial entity or equivalent documentary proof, and a proof of identity of the individual who is empowered to represent, or manage or has ownership over the body, as stated in the Law, complemented with copy of the articles of association and of the identity of the directors and shareholders, and documentary information concerning the commercial or professional activity of the company or body. Similarly, for physical persons, steps must be taken to check the information provided to liable entities of the financial system. Article 51.d of the 2000 AML Law requires verification of the identity of the beneficial owner(s) by members of the financial system and other subject entities with respect to any client with an interest in any operation that, "based on the amount or the conditions of its transaction, leads to suspicious of an act of money laundering." Finally, Article 43 requires that those who act on behalf of a third party are obliged to duly inform themselves of the source of the funds they receive and the identity of the true owner, in order to avoid any money laundering operation. Article 3 of the Internal Rules expands on the statutory requirements and requires those liable within the financial system to "verify diligently whether their client truly has a claim to the transaction requested or effected" and to "obtain information that enables them to know the identity of the person who gave the order for the transfers received and the beneficiary of the transfers sent" Under Article 51.f of the 2000 AML Law subject entities must maintain client identity document and other above mentioned documentation for no less than ten years from the date on which their relationship with clients are concluded and UPB is entitled to inspect these records under article 53 of the 2000 AML Law. Further, UPB has access to any information or documents from subject persons or entities needed to verify the application of the law. The Internal Rules, Articles 7.3 and 8.2 require that transaction records be sufficient to permit reconstruction of transactions for a minimum of ten years and to provide adequate proof of the carrying out of the operations and the identification of the client. Article 46 of the 2000 AML Law describes the obligation to report suspicious transactions. Generally, financial intermediaries are required to report to UPB "any operation or planned operation regarding money or valuable with respect to which there are suspicions of an act of money laundering." Moreover, Article 51.a requires special vigilance over all operations "that, while they may not be suspicious, occur under complex or unusual conditions and do not seem to have an economic justification or legal purpose, particularly operations that are characteristically susceptible of involving money laundering operations and categorized as requiring special vigilance by the UPB through technical releases". Article 3 of the Internal Rules require those liable to "obtain the necessary justification from their clients when they are asked to carry out operations where the sum involved or the conditions of its carrying out do not correspond to the normal activity or previous operations of this client" (A.3. A draft Comunicat Tecnic detailing 23 operations possibly linked to money laundering has been prepared by UPB, focusing on complex or unusual transactions or patterns, where the economic purpose is difficult to establish or the supporting documentation is insufficient or difficult to verify. This

	Comunicat Tecnic has been sent to the Ministries of Finance and Interior for comments by the legal advisers and shall be finalized by the end of February 2002 and thereafter will be published in the Official Journal. Article 47 of the 2000 AML Law requires suspicious transaction report be made before subject persons or entities have carried out the doubtful financial or economic operation. However, Article 4.1 of the Internal Rules provide guidance to those liable whenever the ex-ante reporting has not been possible because the suspicions have come to light subsequently. The declaration shall therefore "be made as soon as they [suspicions] have been aroused" and "those liable are obliged to inform UPB of any new element of which they have knowledge that may affect the estimation of the operation declared." The Internal Rules further requires subject persons and entities to adopt internal procedures to ensure suspicious transactions are monitored and reported. (Articles 7.2 and 7.3). The internal procedures must provide for immediate notification of the facts of the suspect transaction to the internal compliance officer and the compliance officer is required to acknowledge receipt of the suspect fact or operation and to provide the reporting employee with information concerning the disposition of the report. Article 50 of the 2000 AML Law specifically exempts reporting and monitoring of suspicious transactions to UPB from the criminal provisions on bank and professional secrecy. While acknowledging the status of banking and professional secrecy in Andorra, the Law provides that banks "may only furnish information relating to relationship with their clients and their accounts or deposits within the context of a judicial proceeding and with a prior written order from a magistrate." Article 50 also provides a safe harbor for disclosure to UPB, stating "the disclosure of information to this unit shall relieve subject persons and entities and their staff of any type of liability for violating the standards of secrecy and confidentiality, both general and contractual, even when a report of an illegal activity that is made on the basis of suspicion is not actually confirmed" Article 49 prohibits subject persons and entities from warning or "tipping off" their client that a report for suspicious activity has been made to UPB or that any action has been taken. Article 52 requires financial institutions to establish and maintain internal procedures to prevent and detect potential money laundering. Article 48 requires entities of the financial system and insurance and reinsurance companies to appoint a designated compliance officer "responsible for organizing and monitoring compliance with the regulations against money laundering within each entity and authorized to make reports and be the customary representative before the UPB." Article 7 of the Internal Rules requires that the internal control and communication organs to be "adequate and sufficient", which is to be understood as possessing "adequate human, material, technical and organizational resources to fulfill their mission" They must also inform UPB in writing of any change that may take place in this respect pursuant to Article 6.1 of the Internal Rules. Article 52 also requires subject entities to provide training to make employees aware of domestic anti-money laundering framework and related procedures and policies. Article 9 of the Internal Rules requires training for all staff and specifies for any staff entrusted with work with characteristics that make it suitable for detecting suspect facts or operations, shall receive training "that will enable them to detect and know how to proceed in suspect cases" UPB must receive, at the end of each financial period, a specific report dealing with compliance to the anti-money laundering domestic regime drafted by the external auditors of the entity (Article 52.2). External auditing obligation extends to all entities subject to the 2000 AML Law.

	UPB issued a Comunicat Tecnic dated of January 14, 2002 to describe the specific requirements of reporting criteria for the content of the auditors' report. It requires the following points to be addressed: 1- composition of the internal control body and positions of his member(s) in the organizational chart of the financial institution; 2- Frequency of meetings of its members and availability of minutes of such meetings; 3- Details on supervisory and compliance procedures, channels of communication, and degree of implementation of such procedures; 4- Number of suspicious transaction reports, distinguishing between the reports made internally by the employees to the compliance officer, and the reports transmitted by the compliance officer to UPB; 5- Detailed description of training conducted, including dates, topics, number and quality of participants; 6- Conclusions of the auditors with respect to the efficiency of the financial institution's internal procedure to prevent and detect money laundering operations, degree of compliance to the Andorran legislation, and possible recommendation for improving the internal AML regime. Item 4 is in compliance with the provisions of Internal Rules Article 7.2 and 7.3, which describe the internal control measures with respect to the reporting of suspicious transactions. The report on AML compliance signed by the auditors shall be sent to UPB no later than three months following the closure of the exercise. Article 7.4 of the Internal Rules allows for the possibility for UPB to "suggest appropriate improvement and correction measures as applicable and follow these up" although the rules do not further specify means and way to ensure that recommendations are effectively implemented. Article 57 of the 2000 AML Law provides for sanctions for administrative violations and failure to comply with any of the requirements of the Law. The sanctions, which are applicable without diminishing the liabilities that may be applied through a criminal procedure, are imposed by the Government (Council of Ministers) at the recommendation of UPB. Article 58 provides sanctions for "very serious," "serious" and "minor" violations. "Very serious violations", are defined as the failure to satisfy the reporting requirement, tipping off, refusal, excuse or resistance to furnishing information to UPB and repetition of a serious violation in the same year. "Serious violations" are defined as the failure to confirm the identity of clients, failure to demand client identification documents required under Article 51, insufficient verification of the true beneficial owner of a transaction, lack of vigilance and failure to verify identity, failure to retain documents for the 10 period established in Article 51, insufficient internal procedures and failure to carry out the specific audit on AML compliance, and repetition of a minor violation in the same year. "Minor violations" are defined as the failure to inform UPB of the identity of the compliance officer and any violation of the standards of the Law not mentioned previously. According to Article 59.2, "in order to adjust the penalties within the established limits, the seriousness of the case, the failure to be vigilant, the deficiencies or inadequacies in preventive mechanisms and the intent or degree of negligence that has been incurred must be taken into account". Article 59 provides for sanctions ranging from a fine of 60,000 to 600,000 euros and a temporary suspension of directors of the entity or the professional involved for very serious violations, a fine of 6,000 to 60,000 euros and a prohibition on carrying out certain type of commercial or financial operations and/or the temporary suspension of directors of the entity or the professional involved for 1 to 6 months for serious violations, and a fine of 600 to 6,000 euros and a written reprimand for minor violations. Sanctions are recommended by UPB and administered by the Council of Ministers.
Assessment	Compliant
Comments	In application of the Article 52 of 2000 AML Law, Article 10.1 of the Internal Rules stipulates "all those liable, when so required by UPB must send a specific report, prepared by external auditors, on compliance with the precepts of the Law". Generally, in client-auditors relationships the auditor sends the report to the client, who in turn will send it to the relevant

	authorities. However, some rule should prevent the subject bodies from altering the version of the auditors' report when sent to UPB, by requiring that copies certified and sealed by the auditors be submitted to UPB. The client should also be required to provide a waiver permitting the external auditor to meet directly with UPB for follow up necessary to the annual audit. Under Article 6.1 of the Internal Rules, the bodies operating in the Andorran financial system and insurance and re-insurance companies must notify UPB in writing of the identity of the compliance officer(s) and of any change that may take place. This duty should be extended to any change within the AML regime, if any, taking place between two audits carried out by the external auditors. UPB has wide range of tools available to ensure compliance. At minimum, UPB should have a specific procedure and timeframe for follow-up to the bank external audit reports that include meetings directly with the auditors and the banks, and to conduct on-site inspections if necessary. If there are serious deficiencies, UPB should consider requiring an interim external audit to evaluate the progress of corrective measures. UPB should consider whether preparatory meetings with external auditors is needed.
Legal requirements for supervision and regulation ***Fit and Proper Test and Financial Transparency*** Laws should provide that financial institutions and other financial intermediaries are not controlled by criminals. Laws should also provide that companies or other entities subject to any specific benefit from or regulation by the state are not controlled by serious criminals.	

Description	Article 1 of *the 1993 Law Regulating the Financial System* provides regulation for the various groups comprising the financial system, without prejudice to powers or rules attributed to special activity and their possible future extension or modification. It affects "all those individual or legal entities who carry out a professional activity in the financial sector" (i.e. habitual carrying out of banking operations and rendering of financial services) and "it established the legal framework regulating the carrying out of their activities." Article 13 of the *the 1993 Law Regulating the Financial System* regulates the personal and professional characteristics as follows: "The Members of the board of Directors must be persons who do not have any criminal record due to intentional crime and who have a good personal and professional reputation. Apart from the aforementioned characteristics, those responsible for the management of each entity must have adequate professional qualifications". Article 2 of the Code of Conduct further specifies "Those persons who effectively decide to carry out credit entity activity should be honorable and have sufficient experience to carry out this function. A person cannot be a member of a board of directors of a credit entity or administrative, direct or manage a credit entity either directly or through an intermediary, or be empowered to sign on behalf of an entity: 1- If he/she has been condemned for crimes of falsification, infidelity in the custody of documents, violation of secrets, embezzlement of public funds, against public finance or property; 2- If he/she has been condemned for any kind of crime under Andorran Law to a prison sentence for a period exceeding one year; 3- If he/she has been declared bankrupt or insolvent debtor, and has not been discharged". Under the terms of the Law Regulating Operational Activities of the Various Components of the Financial System enacted on December 19, 1996, physical persons and legally constituted bodies which are or become part of the Andorran financial system had to file a dossier for the updating of their permit. As regard physical persons, compulsory supporting documentation was the following: 1- Certificate of residence, 2- Certificate of a clean criminal record, 3- Presentation of the appropriate diploma, certifying a good reputation and adequate professional qualifications, 4- Memorandum of financial activities during the last two financial years, 5- Other professional activities engaged in by the applicant (First transitional provision Article2). The *the 1993 Law Regulating the Financial System* stipulates that no individual or legal entity may professionally carry out activities in banking, financial entities with loan activities and other financial entities without the corresponding authorization, infringement to this provision being subject to sanctions (Second Provision of the Final Provisions). Upon enactment, the Law required that all those individuals or legal entities which carry out their professional activities in the financial sector or who are authorized to operate therein, had to apply for the adaptation of their authorization by June 30, 1994. As far as legally constituted bodies are concerned, the application had to be documented with: the registry certificate of authorization, the balance sheet and statement of profit and loss for the two previous years, composition of the current board of directors and the superior administrative body and composition of the share capital. (Second Transitional Provision). Fourth provision dealing with new applications for authorization stipulates that the Government will appropriately regulate the procedure to be followed and the documents to be presented. The 19/12/96 Law Regulating Operational Activities of the Various Components of the Financial System requires that application for this bodies be accompanied by: 1- Certificate of the registration of the permit, 2- List of shareholders, 3- Certificate to the effect that shareholders with more that 10% of their equity have no criminal record, 4- Audited balance sheet and profit and loss account for the last two financial years, 5- Memorandum of activities for the last two financial years, 6- Composition of the present board of directors or of the higher administrative body.

Assessment	Largely compliant
Comments	It is advisable that as part of the proposed legislation that will restructure the regulatory system for banks, including the powers of INAF, that all employees of a bank be required to meet the fit-and-proper standards and that the bank conduct screening to ensure that employees do not have a criminal record.

Criminalization of money laundering and terrorism finance

Laws should provide for the criminalization of money laundering and terrorism finance. Money laundering and financing of terrorism should be separate offences. Money laundering should extend to all serious crimes and should be defined in accordance with the definitions set out in the Vienna and Palermo Conventions. Financing of terrorism should conform to the definition set out in the UN Convention on Financing of Terrorism.[12] The criteria below are consistent with FATF Recommendations 1, 4, and 5 and FATF Special Recommendation II.

Description	The Andorran Penal Code originally criminalized money laundering offenses in 1990 and was substantially enhanced in 1995. There are four separate provisions that address money laundering offenses. Article 145 of the Penal Code imposes criminal penalties for whomever commits an act with the aim of concealing the origin of money or assets resulting from drug trafficking, kidnapping or hostage taking, illegal arms sales, prostitution or terrorism. Article 145 is very broad and applies to persons who "should have known" Article 146 of the Penal Code increases the penalties for aggravated laundering, specifically when crime was committed with the intent to derive a profit or is part of an organized criminal effort to commit a criminal offense abroad. Article 147 of the Penal Code provides that crimes committed outside of Andorra can constitute predicate crimes so long as the underlying predicate crime can be prosecuted in Andorra. In addition, Article 303 of the Penal Code imposes criminal penalties for certain negligent failures, including the failure to keep required records or to engage in customer due diligence that results in money laundering offenses described in Article 145 of the Penal Code. As stated above, criminal penalties can be pursued without regard to whether administrative sanctions under the 2000 AML Law have been imposed. Article 145 imposes a penalty of eight (8) years imprisonment and a fine of 20,000,000 pesetas. Article 146 imposes a penalty of ten (10) years imprisonment and a fine of 80,000,000 pesetas. Article 303 imposes a penalty of one (1) year in prison and 5,000,000 pesetas. Individuals who are convicted may also be subject to a temporary or permanent ban on exercising a profession. Article 9 of the Penal Code expressly extends criminal liability under Articles 145 through 147 to legal entities for crimes committed by their organs or representatives. Legal entities that are convicted are subject to fines, dissolution of the legal entity, and temporary or permanent closure of the business, among other penalties found in Article 36 and 27 of the Penal Code. Article 147 of the Penal Code mandates that money or securities associated with money laundering offenses set forth in Articles 145 and 146 be confiscated. It is unclear whether the term *valors* in Article 147 also extends to other assets that may represent the proceeds of crime. (See below, **Confiscation of proceeds of crime of assets used to finance terrorism**.) However, Article 37 of the Penal Code permits confiscation of assets that constitute the instruments of crime. In addition, Article 42 of the 2000 AML clarifies that all individuals or legal entities whose

[12]The key elements are outlined in FATF 40 4-7; UNML Articles 1 - 10, 17, 19-23, 28 - 48, 53 – 55; 56-79, UNMC Articles 21 through 33 (attached).

	economic actions may channel or facilitate a money laundering operation are under the duties of the law, including customer due diligence and cooperation with UPB. Accordingly, it appears that all such individuals or legal entities may be criminally prosecuted under Article 303 of the Penal Code for omissions of the required verifications or through negligence, imprudence, or incompetence that causes a violation of Article 145 of the Penal Code. Andorran prosecutions do not require that a defendant be convicted of the predicate crime in order to pursue a prosecution for money laundering. Indeed, there is no need in the law or in the development of the prosecutions that require that the defendant charged with money laundering be involved in the predicate crime whatsoever. Rather, conviction requires some strong indication that a crime has been committed. Often, the information on the underlying crime is received through international requests for mutual assistance and it is discovered that a portion of the laundering has taken place within Andorra. Therefore, on a practical level, prosecutions for money laundering offenses in Andorra often arise out of crimes committed abroad and only the portion of the laundering activity that takes place in Andorra is prosecuted locally. Nevertheless, Andorran law permits prosecution for both the predicate offense and money laundering without risk of double jeopardy. Terrorism crimes are separately criminalized within the Andorran Penal Code. Article 82 criminalizes terrorist acts, Article 83 criminalizes providing support to terrorist organizations, and Article 84 criminalizes financing of terrorist organizations. These crimes are punishable by imprisonment of between 8 and 30 years depending on the gravity of the violation and whether the acts resulted in death or grave injury. In addition, Articles 85, 86, and 87 of the Penal Code respectively criminalize lodging or providing means, providing or procuring arms or explosives, and aiding of terrorist groups. Terrorism, as criminalized in these provisions, are included as predicate crimes for money laundering as specified in Article 145 of the Penal Code. Andorra signed and ratified the Vienna Convention on January 27, 1999. The government signed the UN Convention of the Financing of Terrorism on November 10, 2001 and the Palermo Convention on November 12, 2001. The Ministry of Foreign Affairs and the Ministry of Interior and Justice are beginning to review whether Andorran laws will need to be amended to conform with these latter two conventions, although much of the review for the Terrorism Convention took place prior to signing and conforming changes required were accomplished as part of the 2000 AML Law. On December 21, 2001, Andorra responded to the United Nations Security Council Resolution 1373 (2001) with a detailed report outlining Andorra's legal framework to combat the financing of terrorism. In addition, UPB prepared a self-assessment concerning the eight special recommendations on terrorism that FATF had asked its members to conduct. Although Andorra is not a member of FATF, the government has made the fight against terrorism a priority and completed the self-assessment. The 2000 AML Law was adopted in large part to conform Andorran laws to the requirements of Vienna, Strasbourg, and Terrorism Conventions. With respect to criminalization, the effect of the 2000 AML Law has been to clarify how criminal investigations conducted in foreign countries will be handled within Andorra. At the request of a foreign country, Andorran judicial authorities may initiate a criminal proceeding for a crime committed abroad if the defendant is in Andorran territory or if extradition is not possible or if the defendant is already detained in Andorra for more serious crimes. It should be noted that Article 226 of the Penal Code, which criminalizes malicious disclosure by banks or employees of a bank of confidential information concerning clients is not applicable to disclosures to UPB or to the courts in execution of an international letter rogatory, as stated in Articles 32 and 50 of the 2000 AML Law. Professional bank secrecy is not a hindrance to the investigation and prosecution of criminal cases.

Assessment	Compliant
Comments	Andorra's criminalization provisions provide adequate coverage and criminal sanctions for money laundering and financing of terrorism offenses. The assessors have been advised that a working group within the Andorran Parliament has begun a revision of the Andorran Penal Code to reflect Andorra's obligations under the various conventions. The assessment team has been informed that the revisions, at the very least will be expanded to include as predicate crimes all crimes for which the maximum sentence is at least four years, in conformance with the Palermo Convention.

Confiscation of proceeds of crime or assets used to finance terrorism

AML/CFT laws should provide for the confiscation of the proceeds of crime and of assets used to for FT as well as instrumentalities used to commit predicate crimes to L, for ML itself or for terrorism, *but should adequately protect the rights of innocent parties* (see FATF 7, 35, 38, III).

Description	Andorran measures that provide for the confiscation of proceeds of crime and assets used to finance terrorism are contained both in the Penal Code and in the 2000 AML Law. Prior to the 2000 AML Law, Article 147 of the Penal Code mandated that money and securities of money laundering crimes be confiscated and Andorran authorities have confirmed that Article 147 extends to confiscation of money or securities arising out of terrorism crimes set forth in Articles 82 through 87 of the Penal Code. For other crimes generally, Article 37 of the Penal Code allows for confiscation of the instruments of all crimes as a secondary penalty to be considered by the ruling judge. It is notable that the Penal Code provisions for confiscation of assets of crime do not explicitly provide for the consideration of the rights of bona fide third parties. Rather, Andorran judicial authorities have informed us that bona fide third parties who have an interest in confiscated property must initiate a suit in the civil courts in order to assert their rights. Nor does the Penal Code provide for provisional freezing for crimes committed domestically. However, as described below, UPB's authority to freeze operations for five days if money laundering or the financing of terrorism is suspected mitigates this concern. The 2000 AML law greatly enhanced the scope of confiscation, particularly as related to crimes committed extraterritorially. In large part, the confiscation procedures provided for in the 2000 AML Law are a direct result of Andorra's ratification of the Strasbourg Convention. The 2000 AML Law provides for both judicial and administrative provisional freezing measures, the latter of which is new within the Andorran legal system. As stated above, Andorran officials are beginning to evaluate the requirements of the Palermo Convention and whether their laws are in harmony with the Palermo requirements, including the obligations with respect to confiscation of assets. The 2000 AML Law contains both confiscation and provisional freezing measures for proceeds of international crime that constitute punishable offenses in Andorra. Article 38 of the 2000 AML Law extends provisional freezing or confiscation procedures to the instruments, proceeds, money, valuables or assets acquired through the crime or their equivalent and to applies to property arising out of all "major crimes". Under the new procedure, an international rogatory request is presented by the Attorney General's office to the Criminal Court (*Tribunal de Corts*), which, after hearing the interested parties, issues a decision that may be appealed before the Superior Court of Justice. The Criminal Court may not revise or modify the foreign seizure but it must rule on the rights of bona fide third parties whose rights were not previously resolved in the foreign decision.

	Article 20 of the 2000 AML Law permits the magistrate at the request of the foreign state that has filed a petition for attachment, confiscation, or seizure, to order appropriate precautionary measures such as freezing of accounts or pre-judgment attachment and to prohibit the alienation of any asset that may be subject to subsequent confiscation either under Andorran or foreign legislation. The 2000 AML Law ensures that Andorran authorities have the power to freeze assets even in the absence of a conviction, if there is an indication that the assets must be frozen or seized to preserve them on a precautionary basis to ensure that the assets are preserved. The 2000 AML Law is broad enough for the judicial authorities to trace or search for assets suspected of being the proceeds of crime, and according to the Andorran judicial authorities, judicial orders regularly provide for tracing of assets prior to seizure. Provisional freezing rulings generally must be resolved within 30 days and the judge must act on requests to lift the measures within 15 days. In addition to the judicial confiscation and provisional freezing powers, Article 47 of 2000 AML Law authorizes UPB, without prior notification of appearance in court of parties, to freeze for up to five days assets suspected to be related to money laundering. If additional provisional measures are need beyond five days, UPB must send the records to the Attorney General for evaluation under the judicial freezing authority in Article 38 of the 2000 AML Law. Article 53 grants UPB separate administrative powers to verify, trace, and investigate the assets that are suspected of being connected to money laundering activities arising out of reports of suspicious activity. The tracing activities of UPB are delineated further in Article 1.2 of the Internal Rules. As a result of these enhanced confiscation powers, UPB and the judicial authorities already have seized $1,800,000. Article 39 of the 2000 AML Law specifies that assets seized in Andorra inure to the benefit of Andorra, unless international treaties or agreements state otherwise.
Assessment	**Compliant**
Comments	The 2000 AML Law increases the confiscation tools available. UPB and judicial officials are currently investigating and developing criminal prosecutions under the newer procedures. The fact that in little over six months in operation UPB has been able to seize $1.8 million demonstrates the efficacy of the process. Andorran judicial officials should ensure that the civil courts have sufficient authority to ensure that the rights of bona fide third parties are considered during seizures arising out of domestic crimes. Such an assessment may require a separate legal analysis concerning the rights of bona fide third parties within the Andorran judicial system. Further, Article 37 of the Penal Code should be clarified to ensure that if instrumentalities, proceeds or assets of crime are not available for confiscation, other property of equivalent value could be confiscated. Equivalency is already contemplated for seizures executed under the 2000 AML Law provisions on international judicial cooperation so for consistency, domestic confiscation should also extend to property of equivalent value when the actual asset or property cannot be located. Similarly, Andorra should consider extending 147 of the Penal Code to allow for seizure of all assets that are the instrumentalities or proceeds of crime so as not to restrict the confiscation of money and securities only. If not already part of the proposed revisions to the Penal Code, the assessors recommend that these concepts be included. In speaking with Andorran judicial authorities, they were not aware of any authority within Andorran law to void contracts or render them unenforceable where parties to the contract knew or should have known that as a result of the contract the authorities would be prejudiced in their

	ability to recover financial claims resulting from the operation of their AML/CFT laws. To the extent that such a requirement would be consistent with Andorran Constitutional principles, the authority to void contracts or render them unenforceable may enhance Andorran efforts to carry out its AML/CFT efforts and should be reviewed.

Financial intelligence units

National authorities should create mechanisms whereby financial information relevant to the prevention of money laundering and terrorism finance is collected, analyzed, and disseminated to appropriate supervisory and law enforcement authorities. Financial institutions' suspicious transactions reports are an integral component of this mechanism.

The typical process is one where the financial institutions are required to make suspicious activity reports, often through their national supervisors, to a financial intelligence unit (FIU or other national AML/CFT Competent Authority). The FIU acts as the central repository to gather information, primarily in the form of the suspicious activity reports, and turns this raw reporting into intelligence that is provided to the appropriate authority to support a national anti-money laundering effort.

The overall effectiveness of fighting money laundering crime (and now terrorism finance) will often depend on the sharing of information and intelligence among several jurisdictions. This sharing of information is facilitated by interaction between FIUs, law enforcement agencies and supervisory agencies.

Description	The 2000 AML Law established UPB as the FIU responsible for collecting, processing and disseminating intelligence information and analyzing reports of suspicious transactions to determine possible money laundering operations and to uncover possible proceeds of crime and terrorist assets. Article 53 delineates UPB's missions "to direct and promote activities to prevent and combat the use of entities in the financial system or other types of entities in the country for money laundering, through procedures and instrumental modalities as may be necessary" UPB became operational on July 24, 2001, and its creation was made public by issuance of a press release and publication in the Official Journal (BOPA). UPB's missions and duties are defined in Articles 53 and 54 the 2000 AML Law. According to the First Final Provision of the 2000 AML Law states "The Government is empowered to fix the specific regulations related to any point in this law which may require a set of regulations in order to be operational" Internal Rules have been drafted by UPB and shall be approved by the Council of Ministers and published in the Official Journal (BOPA) by the end of March 2002. UPB has broad powers to request information as stated in Article 51 of the 2000 AML Law and described above in the discussion of **Client Due Diligence**. Article 1.2 of the Internal Rules specify the medium and the form in which they are to be delivered and the period of time to respond. In addition to subject persons or entities, UPB may obtain any information from the Police or from any official agency to the extent of its mission. (Article 53.2 point 5). It has access to sources of financial and other relevant information to assist in its analysis, and in particular, UPB is directly connected to the following databases: Andorran Registre de Societats [registry of companies], the registry of vehicles, Lexis/Nexis and Informer (company details databases, connection to be effective by the end of February 2002). UPB has on site access to the databases of the following bodies: Police and Interpol, Customs, Social Security, Registre d'antecedents judicials [criminal records], Registre Notarials [real estate]. Finally, UPB has an internet connection through a separate computer dedicated for this purpose. UPB is authorized to send Comunicat Tecnics [technical releases] "to serve as guidelines on

	relevant matters in relation with the prevention of the laundering of money and securities". Moreover Article 1 of the Internal Rule contemplates that UPB will publish the Comunicat Tecnics when these communications are of general interest. Since its creation and until mid-February 2002, UPB has issued 4 Comunicat Tecnic: 1) A list of names of people and entities suspected of links with Al Qaeda received from the FBI and enriched of some additional names coming from the Bank of Spain (dated 10/08/01); 2) a letter calling for enhanced vigilance on operations linked to the entry into force of the Euro currency (dated 10/15/01); 3) Guidelines for the external auditors report on compliance with AML principles (dated 01/14/02); and 4) a draft release that is currently being reviewed by Finance and Interior Ministries based on A. 53.2 point 1 which refers to procedures and instrumental modalities to be developed by UPB to promote and coordinate measures to prevent money laundering, before being published in the official journal. This release provides guidelines for detecting suspicious, unusual or complex transactions. It requires entities to perform enhanced diligence over operations susceptible of involving money laundering operations and "categorized as requiring special vigilance by UPB, through technical releases" (Article 51.a). Article 4 of the Internal Rules details the minimum requirements for the contents of a suspicious transaction report and requires the report be in writing, unless exigent circumstances require otherwise. Subject persons or entities must also notify UPB of any demand received from other official bodies when this demand is related to operations that might possibly involve money laundering. (Internal Rule Article 4.5). The same Article also grants UPB the authority to request additional information on the suspected clients or operation, or to modify and insert additional information requirements to the standard reports on suspicious transaction through technical releases. In any case, Article 47 of the 2000 AML Law stipulates that "whether or not the operation has been carried out, the report must be accompanied by all information relating to the operation or request for the operation" and "the subject person or entity must send UPB any new element they learn about and that may affect the assessment of the operation reported." As discussed above, UPB is authorized to provisionally order the blocking of transactions, on an ex parte basis. The collective agreement of all the members of UPB is required to demand the blocking of a doubtful financial or economic operation, to present cases to the Public Prosecutor's Office [Attorney General], or to send records to the competent administrative authority. (Internal Rule Article 2.8). In the absence of a member, collective agreement shall be understood as among the remaining members of UPB. Under Article 53 of the 2000 AML Law, UPB is expected to submit to the Attorney General the cases in which there are reasonable suspicions that a criminal violations has been committed and to file away the remaining cases and retain the documentation for a period of no less than ten years. (A. 53.2 point 9). The 2000 AML Law requires that those who receive information from UPB adhere to professional secrecy. Indeed, the Internal Rules stipulate that "the authorities, persons or public bodies, or those liable who receive information or communications of a confidential nature from UPB are subject to the professional secrecy regulated by law and may not use this information other than in the framework of the performance of their legally established functions." However, the law specifically exempts UPB from the banking secrecy provision in the Penal Code (A. 50). As stated above in **Client Due Diligence** UPB has strong enforcement tools under the 2000 AML Law. Procedurally, UPB recommends sanctions for violations of the 2000 AML Law. Article 57 stipulates that UPB shall propose sanctions to the Government for administrative violations, notwithstanding the liabilities that may be applied through a criminal procedure.

	UPB brings violations to the attention of the Council of Ministers along with recommended sanctions of fines and/or temporary suspensions of the directors of the bank of the professionals involved, as well as suspending or prohibiting the bank from carrying out certain types of financial or commercial operations. Article 53 requires UPB to inform the agency that has disciplinary power over the financial system of all cases sent to either the Attorney General or the Council of Ministers when entities of the financial sector are involved. Other activities of UPB include any other promotional activities needed to prevent money laundering, such as research or publication activities. UPB contemplates creating a web page by the end of 2002 and, on the basis of the volume and nature of its activity, it will determine the appropriate format for an annual activity report. Article 53 of the Law and Article 9.2 of the Internal Rules give latitude to UPB for designing and implementing relevant means and action to fulfill its mission, including through public awareness initiative and training. Since its creation at the end of July 2001, UPB has conducted a two-day training course for 8 newly recruited police officers on AML legislative and regulatory frameworks and case study. For 2002, UPB is planning to organize training targeted the different sector subject to the Law, and it has been in direct contact with the professional association of real estate agents (AGIA – Associacio d'Agents Immobiliaris d'Andorra) and the association of investment companies (ADEFI – Associacio d'Estitat Financeres d'Inversio). Last, should amendments to the Law or other regulations be necessary, UPB's duties comprises the submission to the Government legislative or regulatory proposals on combating money laundering (A. 53.2 point 11). Article 53 authorizes UPB to cooperate with foreign FIUs, if adequate safeguards as to the use they shall make of this intelligence information. Article 56 provides terms and conditions for such cooperation, permitting UPB to send information regarding operations or planned operations associated with money laundering and international crime, including extracts from the criminal record, to other FIUs either its own initiative or at the request of those agencies provided that the party receiving the information agrees to reciprocity, limiting the use of the information as provided by the 2000 AML Law, and preserving professional secrecy. UPB has already established close contacts with counterpart FIU of neighboring countries and notably Spain (SEPBLAC) and France (TRACFIN) and bilateral agreements are being finalized and shall enter into force by the end of March 2002 (MOU with SEPBLAC is expected to be signed in Feb. 2002 and TRACFIN has planned a visit to Andorra for the same month). The establishment of such agreements must be notified to the relevant administrative authority but written agreement are not mandatory to be able to cooperate with these foreign entities provided that Article 56 of the 2000 AML Law is respected. (Internal Rule Article. 13.1). In any case, UPB has demonstrated its willingness to cooperate with FIUs before the entry into force of these agreements and since the creation of UPB, three requests have been executed with TRACFIN and one with SEPBLAC, leading to the confiscation of USD 1.8 million. UPB has received an acceptance letter from the Egmont Group dated 01/23/02 to inform the Unit that the Legal Working Group of the Egmont Group has reviewed the questionnaire completed by the Andorran FIU in December 2001 and decided to officially endorse the membership of UPB before the next Plenary to be held in Monaco in June 2002. From an administrative prospective, UPB is an independent agency and the Ministry of Interior is responsible for UPB's budget. (Article 53.1). The Government regulates procedures with respect to its organization and operations (Article 54 paragraph 4). The provisional budget for 2002 is established to 60,101.21 euros for current goods and services, i.e. exclusive of staff salaries, which are supported by the general budget of the Ministry of Interior. According to the Law, UPB is composed of a minimum of 3 and a maximum of 5 persons (excluding supporting staff) as follows : 1- A maximum of two person with recognized capability in the financial arena, to be appointed by the Minister of Finance ; 2- A magistrate

	(batlle) appointed by the Supreme Justice Council ; 3- A maximum of two members of the Police appointed by the Minister of the Interior at the suggestion of the Director of Police. The senior member in charge of the Unit is designated by the Ministers of Finance and Interior, among the members of the Unit appointed by them (Article 54 paragraph 2). Article 2 of the Internal Rules defines further the duties of the respective members. The members of the financial area perform the supervision and suitability of the analyses of bank accounts and any supporting documentation and are also be responsible for relations with the bodies within the financial system. The members of the Police are responsible for the preliminary investigation of the suspect operations and for relations and contacts with the national police force. The main functions of the magistrate member of UPB is to watch over the juridical soundness of the cases presented to the Public Prosecutor's Office, to the competent administrative authority, as well as those sent to other equivalent foreign bodies and to provide the contacts with the administration of Justice and other magistrates and send cases involving suspect operations on to the Public Prosecutor's Office. The members appointed by the Ministers of Finance and Interior must dedicate themselves only to the duties assigned to them and they are prohibited from being engaged in any other public or private activity (Article 54 paragraph 3). In addition to carrying out his/her jurisdictional duties, the magistrate attached to UPB carries out the duties of monitoring the legal integrity of the cases submitted, facilitates contacts with the justice department and other magistrates and sends cases on suspicious operations to the competent authorities (Article 54 paragraph 3). Currently, the staff of UPB is comprised of the Executive Director with a banking background, a Police Officer, a Magistrate (Batlle) and a Secretary. At the creation of UPB, a temporary consultant from KPMG was hired for a period of 3 months to assist the Unit in the starting of its activities and the drafting of the Internal Rules. The information and intelligence held by UPB is physically secured in safe boxes containing paper and electronic copies of reports and supporting documentation and the premises are under electronic alarm monitoring. UPB members are bound to professional secrecy (A. 54 paragraph 5), however, they can be called to testify by the defendant in a Court and do not benefit from any special status. Members of UPB are not given specific legal protection from suits arising from the execution of their duties. However, the assessment team has been advised, but has not independently verified, that Article 72 of the Andorran Constitution provides that an employee of the government acts for the state, and thus, suit can only be initiated against the government not against the individual employees of the government. The 2000 AML Law does not provide statutory limitations on the access of financial intelligence developed by UPB. The information and cases investigated by UPB can be used as evidence before a Court. Article 12.1 of the Internal Rules stipulates that at the request of the judicial authorities, UPB "may cooperate in investigations related with money laundering acts that stem from the receipt of rogatory commissions and other judicial investigations."
Assessment	Compliant
Comments	After UPB assesses the external audit process and conducts training in other sectors, some consideration should be given to whether UPB's resources are adequate to manage its various duties and whether increasing staff to the statutory maximum of five people is needed. It is recommended that the Andorran Parliament consider enacting a specific provision protecting the financial intelligence and internal operations of UPB. The ability of UPB to develop investigations in an unfettered manner can be seriously compromised if a criminal defendant, who, for example, claims selective prosecution on the basis of discrimination and obtains internal UPB working papers to show how his or her case was developed for

	prosecution differently from other investigations. The internal workings of how UPB develops recommendations for prosecution should be shielded from such scrutiny. The Constitutional protection shielding government employees from suit should be analyzed for legal sufficiency. If found sufficient, information concerning the scope of the protection should be communicated to UPB and the members of the judiciary for proper administration. In addition, to reviewing the annual audits, UPB should be empowered to order additional external audits on an as needed basis. UPB is an administrative body, which is subject to the general financial audit process of the government, however, there is no specific procedure to audit UPB's operations as a whole. Consideration should be given to an annual audit of UPB.
International Cooperation in AML/CFT matters Laws should permit multilateral cooperation and mutual assistance (including investigation, prosecution, and extradition) in AML/CFT matters based on accepted international practices. (See FATF 3, 33, 34, 35, 36, 37, 38, 39, 40, I and V).	
Description	Andorra enhanced its efforts for mutual legal assistance through the 2000 AML Law. Prior to the 2000 AML Law, Andorran officials inform us that they had an interim law on international cooperation but that did not contain formal procedures for mutual legal assistance or standards to evaluate the requests it received for mutual legal assistance. The 2000 AML Law provides both the procedures and standards, to broaden the ability of foreign countries to submit requests to Andorra and to ensure these are evaluated in a timely and systematic manner. Andorra permits mutual assistance for all offenses that are criminalized in Andorra, which include money laundering and the financing of terrorism. Andorra signed the Council of Europe Conventions on Mutual Assistance and Criminal Matters and on Extradition on July 26, 2000 and incorporated a number of its requirements into the 2000 AML Law. Requests for international judicial cooperation are generally handled through diplomatic channels, arriving through Andorra's Ministry of Foreign Affairs. The Ministry of Foreign Affairs logs the request and immediately submits the request to the President of the Tribunal of Judges [*Batllia*] and sends a copy to the Attorney General [*Ministerio Fiscal*]. The *Battlia* assigns the request to a magistrate who will review it for conformance with general conditions explicitly described in Articles 2 and 4 of the 2000 AML Law. The magistrate will evaluate the contents for sufficiency with the substantive and technical requirements as well as for mandatory preconditions that the request be in conformance with Andorran constitutional principles, the offense is punishable under Andorran law, that the offense is not politically based, the person has not been convicted and completed his sentence or has been acquitted for the same facts and the crime is sufficiently important to justify the intervention of Andorran justice. In practice, gravity of the crime does not appear to be an impediment to cooperation as Andorra has provided mutual legal assistance in 2001 for crimes including driving under the influence of alcohol, default of payment, driving accidents, and bounced checks, among other offenses. Prior to the passage of the 2000 AML Law, requests for mutual assistance were handled in much the same way except it was not required to send copies of the requests to the prosecutors. The new procedure is more formalized with specific time frames to respond. Andorra provides mutual assistance without regard for differences in the standards concerning the intentional elements of the crime. So long as the offenses are punishable under Andorran

	law, mutual assistance can be given. In practice, as long as the request for mutual assistance sufficiently describes a money laundering crime, Andorran judicial officials will execute the request. Article 3 authorizes the magistrate handling the request to refuse to cooperate or to request additional information from the requesting country when the request is deficient. Andorran authorities informed us that frequently requests from Spain are sent back because they contain incomplete information. When necessary for expedited processing, the request can be sent directly to Andorran judicial authorities, through diplomatic channels, or through the International Criminal Police Organization (INTERPOL), pursuant to Article 10 of the 2000 AML Law. Andorran judicial authorities informed us that INTERPOL requests are frequently sent on an expedited basis directly to the judicial authorities and that this process has worked well. Articles 5 and 6 of the 2000 AML Law mandates that information obtained through Andorran judicial cooperation only be used by the requesting state for the purposes specified in the original request and that Andorran judicial authorities may condition their cooperation on receipt of a prior commitment from the requesting country of this condition. Requests for judicial cooperation may also be given when the requested cooperation is intended to exculpate the person charged. The scope of the legal assistance permitted in the 2000 AML Law is broad. Extradition, seizure, detention, questioning of witnesses, and initiation of criminal proceedings in Andorra for foreign criminal violations are expressly included. Generally, the magistrate can order the seizure of assets or property upon receipt of the request from a foreign country. Certain requests such as for bank accounts and the interception of telephone, teletype or other similar means will require a hearing before the magistrate by the Attorney General and with the prior verification that the request is consistent with Andorran law, without prejudice to the preservation of banking secrecy. Judicial authorities may authorize controlled delivery of drugs, firearms, artwork, counterfeit currency, child pornography, human organs or proceeds of money laundering operations as part of international criminal investigations. (Article 122 *bis* of the Penal Code as added by Section 10 of the 2000 AML Law). In addition to broad judicial cooperation, the 2000 AML Law authorizes UPB to directly communicate with its counterparts in other countries and to offer assistance in foreign investigations. UPB's mandate includes sending information regarding operations or planned operations associated with money laundering and international crime. As required in Article 56 of the 2000 AML Law, UPB will cooperate with its foreign counterparts if the counterpart agrees to reciprocity, a commitment that the receiving state will not use the information for any purpose contrary to the 2000 AML Law, and that foreign counterparts maintain professional secrecy. In addition to the extradition provided for in Article 12 of the 2000 AML Law, Andorra passed *Llei Qualificada d'extradició,* on December 27, 1996 specifically to permit extradition.
Assessment	Compliant
Comments	The framework for judicial cooperation introduced by the 2000 AML Law substantively improves Andorra's ability to respond to foreign requests and to provide meaningful support to foreign criminal proceedings. The Ministry of Foreign Affairs provided us with information demonstrating that Andorra provided or sought mutual assistance with Spain, France, Portugal, United Kingdom, Germany,

	Switzerland, Cyprus, Argentina, Hungary, Argentina, Mexico, Russia and the United States. During 2001, three (3) requests have related to money laundering crimes have been received from Spain, Mexico and France and one request for additional information has been sent out by Andorra to Spain. The statistical information provided from the Ministry of Foreign Affairs does not include requests sent on an expedited or emergency basis directly to the judiciary. If requests for judicial cooperation from foreign countries suggest that a separate investigation is needed within Andorra, especially with respect to money laundering or financing of terrorism activities, the judicial authorities should contemplate introducing a formal mechanism to inform UPB about the matter.
Controls and Monitoring of Cash Transactions **(For information only, not assessment)**	
Describe controls on the import and export of bank notes	Andorra does not monitor or require the reporting of currency imported or exported. Because Andorra does not have a national currency the government has not found a need to monitor the currency inflows and outflows on a macroeconomic basis. Before enacting the 2000 AML Law, Andorra considered whether currency transaction would be appropriate for the types and levels of cash activity in Andorra. The government concluded that cash transaction reporting would not be appropriate for Andorra and, in observing the experience of other countries, concluded that Andorra might end up having excessive unanalyzed information that would not produce useful financial intelligence. Further, the cost of gathering and analyzing cash information would be prohibitive for the capacity of UPB, which currently consists of three members, with a statutory limit of five members. UPB believes there are sufficient controls within the recordkeeping requirements and customer due diligence to mitigate the need for currency monitoring. UPB is adopting in its Internal Rules a requirement that banks, the only business authorized to engage in currency exchange, to limit currency exchanges for non-clients to 3000 euros. UPB is reasonably confident in the banks' procedures for monitoring cash activities. In practice, the limits that Banks have adopted are significantly lower, usually 300 euros for non-clients without identification and 1500 euros with identification. Generally, the banks will only exchange a limited range of currencies, including Spanish Pesetas, French francs (now both using Euros), Swiss francs, Sterling pound, and U.S. dollars. Certain cash transactions such as exchanging large bills for small or vice versa trigger the filing of suspicious transaction reports to UPB. By way of example, one bank has a policy to not exchange currency for non-clients for more 1500 euros and for any exchange over 300 euros the bank will take a copy of the person's passport. For clients, the bank will exchange funds of up to 6000 euros but above that amount any exchange will require special approval by the group where the account is housed. Similarly, the bank has internal procedures to detect smurfing and deposits that appear transient, early repayment of loans, and if withdrawals from an account would exceed 80% of total deposits in one month. On a monthly basis, the bank monitors and seeks additional information from customers for transactions over 60,000 euros and 120,000 euros. Other banks have similarly low thresholds for currency exchange. Banks will not engage in wire transfers for non-clients. For client transactions, the banks frequently will require the client to give identifying information about the source of the funds prior to releasing the funds to the client. Other financial entities, including wealth management firms, are required to have a bank account where there is already a filtering and record of cash transactions. In addition, wealth management, real estate, notaries, lawyers, accountants and others who may receive cash or

	securities are subject to the requirements in the 2000 AML Law, including customer due diligence, identification of beneficial owners, and suspicious transaction reporting. Businesses who trade in high value goods with cash purchases of over 15,000 euros are also subject to the 2000 AML Law. The Internal Rules provide that when the sum involved or the conditions of carrying out the purchase arouse suspicions of an act of money laundering, the sellers of high-value articles must verify the identity of the purchasers, must keep a copy of these documentary proofs and must declare the operation to UPB. A draft Comunicat Tecnic as described in greater detail in **Financial Intelligence Units**, requires suspicious transaction reporting of any unusual, complex, or suspicious transactions and details a comprehensive series of transactions where reporting is required.
Describe procedures for monitoring and recording cross-border movements of large amounts of cash	Customs officials do not monitor the cross-border movements of large cash amounts.
Describe factors which influence the use of cash in transactions	The mission did not review the factors that influence the use of cash in transactions in Andorra.

Part 2: Assessing the AML/CFT in prudentially-regulated sectors

Module 1—AML/CFT in the banking sector

Table 6. Detailed Assessment of AML/CFT Elements for Banking Supervision

Organizational and Administrative Arrangements The supervisor determines that banks have in place policies and procedures that are adequate to deter improper use by criminal elements. Measures should provide for prevention and detection of money laundering and other criminal activity, as well as ensure appropriate reporting of suspected money laundering activities. Supervisory and institutional arrangements below are consistent with FATF Recommendation 19, 26 and 27 referring to the role of the supervisor and establishment of internal policies, procedures, audit and training programs to deter money laundering. The supervisor promotes high ethical and professional standards by banks	
Description	The scope of the supervisory powers is discussed in detail in Part 1above, under **Financial Intelligence Units**. Bank compliance with AML/CFT requirements has been part of the law since 1995. Prior to 1995, the ABA Code of Conduct governed certain know-your-customer areas. Prior to the 2000 AML Law, INAF would receive as a portion of the external audit reports prepared annually reports on the banks' AML internal controls and practices and procedures. After the 2000 AML Law, the supervisory authority with respect to AML/CFT matters passed in its entirety to UPB. On a statutory basis, UPB has the authority to ensure that banks maintain special vigilance over all operations, that banks' internal procedures contain appropriate and sufficient control to prevent and impede money laundering operations, conduct training, require banks to provide any information UPB might need to investigate, and to verify that banks are

	acting in compliance with the law. To this end, UPB has provided specific direction to the external auditors of the banks concerning the scope and necessary content of the external audit report that is provided to UPB. The law currently provides that UPB receive the external audit report at the end of each financial period. UPB has requested that these reports be submitted by March 31, 2002 for the financial period ended December 31, 2001. UPB has the statutory authority to independently verify the results of the external audits, including inspection of the records and entering the banks. UPB has stated in Article 7, paragraph 4 the Internal Rules that UPB may suggest appropriate improvement and correction measures as applicable. The 2000 AML Law requires banks to inform UPB of the designation of a compliance officer charged with anti-money laundering responsibility. As part of the external audit, UPB ensures that banks have developed training programs against money laundering. UPB does not have a specific role in ensuring that banks have high ethical standards of professional conduct and fit-and-proper requirements. The requirement that bank officers and directors be subject to screening for criminal convictions and qualifications has been administered by INAF under Article 13 of *the 1993 Law Regulating the Financial System.* The 1993 Law, however, only addresses executives and directors, not employees. Nevertheless, the banks themselves have internal procedures for ethical conduct that apply to all employees and in all banks the mission met with employees are required to sign a declaration acknowledging their ethical responsibilities and their responsibilities with respect to anti-money laundering. UPB does not have plans to conduct training specifically for the banks since the banks and the ABA have sufficient depth of knowledge of anti-money laundering requirements to conduct their own training. As discussed in Part 1, UPB has strong powers to recommend sanctions. UPB has in-house capability on financial fraud and money laundering prevention obligations. UPB currently consists of three members, two of whom are charged with the investigative and operational matters assigned to UPB. The third is the judge who advises UPB on legal integrity of the cases submitted and acts as the liaison to the judiciary and the justice department. The two operational members both have significant experience. The executive director has worked in bank operations and compliance since 1968 and the police member has 15 years of investigative experience, including investigations with SEPBLAC, INTERPOL and other international investigations.
Assessment	Compliant
Comments	UPB should have in place a formal mechanism to inform INAF of AML/CFT weaknesses that indicate a larger management or systemic problem that may affect the prudential soundness of the institution.

Customer Identification and Due Diligence

The supervisor determines that as part of their anti-money laundering program banks have documented and enforced policies for identification of customers and those acting on their behalf. The information requirements on customers need to be commensurate with the assessed risk of money laundering posed by those customers. The customer identification requirements are consistent with the Basel Committee paper on Customer Due Diligence for Banks and FATF Recommendations 10 and 11

Description	The legal framework for customer due diligence is detailed above in Part 1. UPB determines through the external audits, whether the banks are carrying out customer due

	diligence by verifying the implementation of the procedures set out in the 2000 AML Law. External auditors are asked to verify by sampling, which includes numbered accounts. UPB also asks the external auditors to ensure that banks are complying with their own internal policies and procedures and to report on any deficiencies found. In practice, the banks have had long-standing customer due diligence procedures that operate at both at account opening and before transactions are initiated. The due diligence measures were first formalized after the 1990 Code of Conduct agreement was signed by all the banks. The banks require the physical presence of the customer in order to open an account. This requirement is being formally incorporated into the revised Code of Conduct. The banks check customers against internal lists of problem countries, comprised to some extent on the FATF Non-Cooperative Countries and Territories List ("NCCT"). Clients coming from other countries, already subject to the normal identification verification procedures, are required to present reliable references and if the potential client is a business entity, the banks will conduct its own investigation on the status of the business. The processes are consistent throughout the banks, whether in the agencies [branches] or in private or commercial banking. Most often, the opening office is required to submit the customer information to the compliance officer for further review before opening the account. The banks also have software programs that measure the risk of the client based on the country of origin, volumes of debits and credits requested, the type of banking activity, the business activity of the client, overall annual volume of the business, countries with whom the client has transactions, who introduced the customer, the methods available to verify the source of the customer's information. High-risk customers are subject to increased scrutiny and most banks require that this increased scrutiny be conducted by the compliance officer or within the centralized compliance office rather than at the agency [branch] or unit level. Beneficial ownership information is also reviewed centrally in most banks. The procedures are carried out for all numbered accounts as well. Wire transfers within the banks are limited to known-customers and if the transaction is inconsistent with the customer's business or activity or the transfer is to or from a country that raises suspicion the bank will not complete the transaction until the customer has provided information supporting the basis of the transaction. The banks are quite careful to not release wire funds until customer information is obtained. If the customer fails to supply information requested, the transfer will trigger a suspicious transaction report.
Assessment	Compliant
Comments	UPB should ensure that it receives up-to-date copies of each bank's internal procedures for customer due diligence and should follow-up with the banks timely on the adequacy of the submitted procedures.

Monitoring and Reporting of Suspicious Activities

The supervisor determines that banks have formal procedures to recognize and report potentially suspicious transactions. Banks and FIUs should establish and regularly revise systems for detection of unusual or suspicious patterns of activity that provide managers and compliance officers with timely information needed to identify, analyze and effectively monitor customer accounts.

Description	The monitoring and reporting of suspicious activities is detailed above in Part 1. Although the 2000 AML Law does not require UPB to determine the manner and format in which suspicious transactions should be reported, Article 4 of the Internal Rules, specifies that

	the communication made by those liable shall be made in writing (although for efficiency of communication purposes, it may be made by other means and confirmed in writing immediately afterwards) and A. 4.4 requires the report of suspicious transactions to contain at least the following information: 1) Information on the person making the declaration; 2) Copy of the documents used to identify the client who has made or is attempting to make the doubtful financial or economic operation; 3) Copy of the supporting documentation, if any, proving the doubtful financial or economic operation; 4) Description of the operation declared and reason for the communication to UPB; and 5) Any other information in the hands of those liable that might help UPB to understand and analyze the operation. Since the 2000 AML Law went into effect in July 2001, UPB has received 24 suspicious transaction reports, all from banks. UPB monitors through the external auditors the number of suspicious transaction reports are made by employees to the compliance officer and the number of suspicious transaction reports that are submitted from the bank to UPB. The assessors understand that UPB has asked for this information from the external audit in order to ensure that the suspicions of bank employees are not being quashed by senior management and that sufficient information exists within the bank to justify why some reports were not formalized into suspicious transaction reports to UPB.
Assessment	Largely Compliant
Comments	The banks stated that the standard under the 2000 AML Law is far easier for them to follow than the previous reporting requirement in the 1995 Law. However, the banks want additional guidance on how to behave when UPB blocks a transaction and the customer complains that his operations have not been performed. After UPB issues the final Internal Rules, which specify the manner and content of the suspicious transaction report, it should evaluate after a period of operation whether the instructions provided are sufficient to generate meaningful reports and make any necessary adjustments to the reporting requirements soon after. After a period of such review and adjustment, the monitoring and reporting of suspicious transactions is likely to be compliant with the AML/CFT Methodology criteria.
Record Keeping, Compliance and Audit The supervisor determines that banks have formal record keeping procedures regarding customer identification and individual transactions and the retention period. Record keeping procedures should be regularly reviewed for compliance with applicable laws and internal policies. The criteria used are consistent with FATF Recommendation 12.	
Description	Recordkeeping is mandated by the 2000 AML Law for a minimum period of ten years from the time the customer relationship with the bank is terminated. In practice, the banks have longer internal recordkeeping rules, often extending to thirty years, the statutory period for some liability provisions in Andorran civil law. Even prior to the 2000 AML Law, when the recordkeeping requirement was a five-year minimum period, the banks out of an abundance of caution regularly exceeded the limit. The banks are committed to ensuring that compliance is vested with an officer of sufficient experience and authority to ensure that the requirements of the law are followed. It is the Mission's impression that these compliance officers receive substantial support from the senior management of their respective banks. More than one bank has a compliance committee at a senior management level to ensure consistency throughout operations. Because UPB is informed of the designation of the compliance officer for each bank, and the financial

	community is small, any deficiencies in the designation of a compliance officer is likely to be promptly noticed and addressed by UPB. UPB is relying on the external auditors to carry out the bulk of the necessary review and assessment of the adequacy of the banks' anti-money laundering policies, procedures and internal controls. To ensure the depth of the external audit is sufficient, UPB issued a detailed Comunicat Tecnic to subject entities outlining the required level of detail needed in the external audit report. The external auditors have access to the customer information, including to numbered accounts, but cannot, however, send confirmations to the holders of numbered accounts.
Assessment	Largely Compliant
Comments	Until the external audit reports are submitted and UPB has conducted follow-up, it is difficult to assess the level of implementation by the banks of the 2000 AML Law requirements and the efficacy of the external audit program. The assessment team has recommended specific UPB follow up on the external audit reports above in **Organizational and Administrative Arrangements**. In addition, for banks, UPB should thoroughly review the contents of the external audit reports for sufficiency of content as well as for the adequacy of the assessment. UPB may find that after this process is completed for 2002 that the scope, content and the form of the external audit will require some modification. UPB should consider prescribing specific sample sizes for transaction and account testing, including a separate sample for numbered accounts.
Cooperation with supervisors and competent authorities The supervisor is able, directly or indirectly *(including through a Financial Intelligence Unit)*, to share with domestic and foreign financial sector supervisory authorities information related to suspected or actual criminal activities.	
Description	UPB has broad authority to share information with the foreign financial sector supervisory as detailed above in Part 1, **International Cooperation on AML/CFT measures**. What is less clear is the channel of communication between UPB and INAF on matters that are of mutual concern on a compliance and prudential basis. UPB believes that its authority to sanction, which requires advice to INAF, empowers it to inform INAF of matters that indicate prudential problems.
Assessment	Largely Compliant
Comments	This is addressed above in **Organizational and Administrative Arrangements**
Licensing and authorizations The licensing authority banking activities should take the necessary legal or regulatory measures to ensure that fit-and-proper persons control financial institutions. Measures should prevent control or acquisition of a material participation in financial institutions by criminals or their confederates. The licensing requirements also conform to FATF Recommendation 29.	
Description	The 1998 Bank Administration Law establishes requirements for new licenses, vesting with the Finance Minister the final approval on decisions to create or withdraw banking licenses based

	on recommendations of INAF and the CSF. Articles 13 and 14 specify the fit and proper requirements for owners, the requirements for authorization and information that must be submitted to the Ministry of Finance by applicants. At this time, Andorra is not granting new licenses to enter banking in Andorra. UPB does not have any defined role in the licensing or determining whether fit-and-proper persons control financial institutions. The 1990 Code of Conduct required banks to ensure themselves that fit-and-proper standards are maintained.
Assessment	Largely Compliant
Comments	The report by the external auditors to UPB should assess whether each bank has in place internal procedures for ensuring that the fit-and-proper standards are followed. Although this is generally a prudential standard and administered by INAF, it would be beneficial for UPB to have access to this information as well, particularly as any evaluation of the susceptibility to criminal activity is materially increased if the fit-and-proper standards are not properly administered.

C. Recommendations and authorities' response to the assessment

Recommendations

Table 7. Recommendations to Improve Implementation of the AML/CFT Measures

Topic	Recommended Action
Part 1: AML/CFT in the legal and institutional framework	
Suggested actions for the legal and institutional arrangements	
Organizational and Administrative Considerations	UPB resources should be evaluated for possible adjustment.
	Provide a formal mechanism for communication between UPB and INAF
	Review suspicious transaction report mechanism and guidance after a period of implementation.
UPB Internal Rules	Waiver should be required authorizing UPB to meet directly with external auditors.
	Require updates to UPB of any change in AML regime between audits, including submission of updated internal procedures.

Topic	Recommended Action
	Formalize UPB's procedure to follow up on the external audits.
	Permit UPB to order additional external audits as necessary.
	Consider auditing UPB's operations.
External Audits	Ensure submission of unedited auditor's reports to UPB.
	Consider possible preparatory meetings between UPB and external auditors.
	Evaluate the criteria for external audit after the first reports are received and consider modifications, including specific sample testing for numbered accounts.
Legal	Complete assessment of compliance with international conventions and complete changes to the Penal Code as necessary.
	Assess the measures to protect bona fide third parties in confiscation proceedings.
	Assess whether it is necessary to permit judges to void contracts that are money laundering related.
	Protect financial intelligence and internal operations of UPB.
	Analyze the scope of Constitutional protection afforded to government employees and advise UPB and the judiciary on the scope.

Topic	Recommended Action
Part 2: AML/CFT in prudentially-regulated sectors	
Suggested actions for AML/CFT in the banking sector	
External Audits	UPB should request external auditors to assess fit-and-proper test procedures of banks.
Potential Comunicat Tecnic	Respond to requests for additional guidance on how banks should handle customers whose transactions have been blocked.
Legal	Subject all employees of banks to fit-and-proper requirements and require banks to screen new employees for criminal records.

Authorities' response to the assessment

Andorran authorities' response to the assessment of the legal, institutional and supervisory aspects for the AML/CFT

The Ministry of Finance repeats its gratitude to the International Monetary Fund for having, at the request of the Andorran authorities, carried out the present assessment. As noted above in the Ministry's earlier response, Andorra shares the IMF interest in protecting global financial stability and in the spirit of co-operation and transparency, the Andorran authorities decided to take part in the Fund's project. In addition, the IMF proposed the carrying out, jointly with the assessment of the supervisory and regulatory framework of the financial system, an assessment in matters of anti-money laundering and combating the financing of terrorism. The Andorran Authorities voluntarily accepted the AML/CFT assessment as part of the Module 2 assessment program.

The approval in December 2000 of the Law on International Criminal Cooperation and Combating the Laundering of Money or Valuables Resulting from International Crime, carried forward the process begun in 1990, when offences of laundering were defined in the Penal Code, and later in 1995 when the first anti-money laundering law was adopted. The 2000 AML Law represented an important change in matters of prevention as it clarified the framework of international criminal cooperation and created the UPB (Money Laundering Prevention Unit). In summary it can be said that the adoption of this new Law, which came into force in June 2001, improves the system for declaration of suspicion, bringing in, among other aspects, legal protection for individuals making a declaration of suspicion, extending the persons or subject entities from financial institutions and principally banks to other agents of the economy that could be used in laundering operations.

In this way Andorra has come to the present system of prevention and anti-money laundering after a progressive development marked by the integration of international standards, via the promulgation of internal legislation and the adoption of international conventions in these matters. Following this same evolution, during 2002 approval was given to the Regulation of the 2000 AML Law, which defined organisational and functional aspects of the UPB, establishing the form in which liable subjects shall comply with the provisions obligations established and defining, among others, the procedures to be followed in the case of detecting a suspicious operation or projected operation. The UPB has also signed a cooperation agreement with its Spanish counterparts (SEPBLAC) and with the French unit (TRACFIN). UPB has also become a member of the Egmont group.

As stated by the evaluation team at the time of the visit, the 2000 AML Law and therefore the UPB have only had seven months in force. Since its starting-up in operation the UPB has opened contacts with agents of the Andorran financial sectors, with foreign counterparts and with international organisations. It is clear that the system is recent and needs a certain running-in time to establish that it is working well, although its welcome by the economic sectors has been positive.

In the spirit of cooperation and improvement characteristic of Andorra, the IMF assessment and recommendations have been received with interest. As the Regulation of the Internal Rules of the UPB was in the preparation phase, most of the recommendations made by the Fund in the preliminary report have been integrated into the definitive text approved by the Government on 27 March 2002. Some of the recommendations, of a more practical kind, will be implemented through technical communiqués or will be demonstrated through the activity inherent to the UPB.

Table 8. Compliance with the FATF Recommendations

FATF Recommendations (40 + 8)	Grading					Remarks
	C	LC	MNC	NC	Not Assessed	
The FATF 40 Recommendations						
1 – Ratification and implementation of the Vienna Convention	X					
2 – Secrecy laws consistent with the 40 Recommendations	X					Article 50 of 2000 AML Law.
3 – Multilateral cooperation and mutual legal assistance in AML	X					See discussion on international cooperation in AML/CFT Assessment
4 – Money laundering a criminal offence (Vienna Convention)	X					Since 1990.
5 – Knowledge of money laundering a criminal offence (Vienna Convention)	X					Applies to those who know or should have known.
6 – Criminal liability of corporations—and their employees	X					Contained in Article 9 of the Penal Code.
7 – Legal and administrative conditions for confiscation (Vienna Convention)		X				Rights of bona fide third parties are not expressly protected.
8 – Recommendations 10-29 apply to non-bank financial institutions	X					2000 AML Law extended anti-money laundering compliance to non-banks.
9 – Recommendations 10-21&23 apply to financial services	X					
10 – Prohibition of anonymous accounts		X				Numbered accounts are subject to all customer due diligence and recordkeeping requirements.
11 – Obligation of reasonable measures for customer identification	X					In place for banks since 1990 and 2000 AML Law extends the obligation to non-banks.
12 – Comprehensive record keeping (5 years) for transactions	X					2000 AML Law requires 10 years.
13 – Attention paid to AML risk from new technologies						
14 – Detection and analysis of unusual or large transactions		X				Requested in Internal Rules.
15 – Reporting requirement for suspicious transactions	X					Applies to all financial intermediaries
16 – Legal protection for good faith reporting to competent authority	X					
17 – No tipping off customers of reports to competent authority	X					
18 – Compliance with instructions for suspicious transactions reporting	X					2000 AML Law authorizes UPB to issue instructions.
19 – Internal policies, procedures, controls, audit, and training programs	X					
20 – AML rules and procedures apply to branches and subs abroad	X					Expressly included in 2000 AML Law
21 – Special attention given to problem countries		X				Andorran Constitution prohibits discrimination on the basis of country of origin. Banks have internal procedures instead.
22 – Detection and monitoring of cross-border transportation of cash					X	

FATF Recommendations (40 + 8)	Grading					Remarks
	C	LC	MNC	NC	Not Assessed	
23 – Centralization of data on currency transactions					X	
24 – Support to the replacement of cash transfers					X	
25 – Prevention of unlawful use of shell corporations					X	
26 – Adequate AML programs in supervised banks/financial institutions	X					Supervisory authority is vested with UPB.
27 – Administrative regulation of other professions dealing with cash		X				2000 AML Law subjects entities to due diligence.
28 – Guidelines for suspicious transactions detection		X				Draft Comunicat Tecnic provides detailed guidance
29 – Preventing control of financial institutions by criminals		X				Article 13 of the Law Regulating the Financial System, November 27, 1993.
30 – Recording of international flows of cash					X	By UPB
31 – Information gathering and dissemination about AML	X					
32 – International exchange of information relating to suspicious transactions, and to persons or corporations involved	X					
33 – Bilateral or multilateral agreement on information exchange when legal standards are different	X					
34 – Bilateral and multilateral agreements and arrangements for mutual assistance	X					
35 – Ratification and implementation of other international conventions on money laundering		X				Palermo Convention and Terrorism Convention have been signed and are pending ratification
36 – Cooperative investigations among countries' authorities	X					
37 – Definition of procedures for mutual assistance in criminal matters	X					Formalized in the 2000 AML Law
38 – Authority to take expeditious actions in response to foreign countries' requests	X					2000 AML Law permits both UPB and judicial officials to take expeditious actions
39 – Mechanisms to avoid conflicts of jurisdiction						
40 – Money laundering an extraditable offence	X					
FATF eight special recommendations to combat terrorist financing						
SR1 – Take steps to ratify and implement relevant United Nations instruments	X					
SR2 – Criminalize the financing of terrorism and terrorist organizations	X					
SR3 – Freeze and confiscate terrorist assets	X					Post September 11, 2001 review did not uncover terrorist assets in Andorra
SR4 – Report suspicious transactions linked to terrorism	X					

FATF Recommendations (40 + 8)	Grading					Remarks
	C	LC	MNC	NC	Not Assessed	
SR5 – provide assistance to other countries' terrorist financing investigations	X					
SR6 – impose AML/CFT requirements on alternative remittance systems		X				The law requires licensing to engage in funds transfers and Article 141 of the Penal Code criminalizes illegal transfers.
SR7 – Strengthen customer identification measures for wire transfers	X					Article 51 of the 2000 AML Law.
SR8 – Ensure that entities, in particular nonprofit organizations cannot be misused to finance terrorism					X	There is a law regulating nonprofit organizations, but the register for associations has not yet been created.

Explanations: Recommendations in italics are reviewed for purposes of the legal framework, but not assessed as to implementation. The rating columns indicate the degree of compliance: C=compliant, LC=largely compliant, MNC=materially noncompliant, and NC=noncompliant