INTERNATIONAL MONETARY FUND

# Andorra's Banking Sector: Opportunities and Risks

Aidyn Bibolov

SIP/2025/152

**IMF Selected Issues Papers are prepared by IMF staff as background documentation for periodic consultations with member countries.** It is based on the information available at the time it was completed on February 9, 2024. This paper is also published separately as IMF Country Report No 24/58.

2025
DEC

SELECTED ISSUES PAPER

 SIP/2025/152

**IMF Selected Issues Paper**
European Department

**Andorra's Banking Sector: Opportunities and Risks**
**Prepared by Aidyn Bibolov**

Authorized for distribution by Rodolphe Blavy
December 2025

***IMF Selected Issues Papers* are prepared by IMF staff as background documentation for periodic consultations with member countries.** It is based on the information available at the time it was completed on February 9, 2024. This paper is also published separately as IMF Country Report No 24/58.

**ABSTRACT:** Andorra has a large and distinct banking sector with a strong focus on private banking. Drawing comparisons with peer microstates and financial centers in Europe, the analysis highlights Andorran banks' reliance on deposits, strong capital and liquidity buffers, and expansion into international markets. Using a panel dataset of 275 private banks across 39 countries, the study identifies key determinants of profitability, including bank size, capitalization, GDP growth, and interest rates. The findings underscore the importance of proactive supervision and macroprudential tools in managing systemic risks, especially in the absence of a central bank. The paper also explores the implications of Andorra's EU Association Agreement on the Andorran banking sector.

**RECOMMENDED CITATION:** Bibolov, Aidyn (2024). Andorra's Banking Sector: Opportunities and Risks, Washington DC: International Monetary Fund, Selected Issues Paper, SIP/2025/152

| | |
|---|---|
| JEL Classification Numbers: | F36, F65, G15, G21, G28 |
| Keywords: | Andorra, Banking sector, Private banking, Financial sector, Assets under management, Profitability, Macroprudential policy, regulation, supervision, EU Association Agreement, Systemic risk, Capital buffers, Liquidity, International expansion, Microstate, Financial integration |
| Author's E-Mail Address: | abibolov@imf.org |

SELECTED ISSUES PAPERS

# Andorra's Banking Sector: Opportunities and Risks

## Principality of Andorra

Prepared by Aidyn Bibolov

# ANDORRA'S BANKING SECTOR: OPPORTUNITIES AND RISKS[1]

*Andorra is a microstate with a large and unique banking sector, dominated by private banking activities. This paper looks at how Andorran banks and its banking sector compare with regional peers-to provide a better understanding of its specificities but also draw lessons from other countries. We analyze how this unique setup influences bank soundness and performance and find, unsurprisingly, that size, interest rates, and economic growth are key to profitability. Policy lessons are derived from the large size of the banking system—which calls for proactive supervision and risk mitigation.*

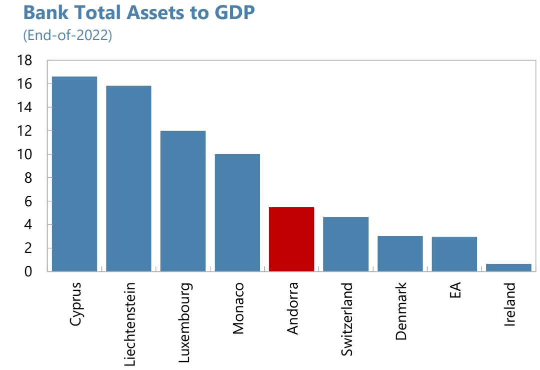
## A. Overview of Andorra's Banking System

1. **The Andorran banking sector plays an important role in the economy.** To compare Andorran banks in a cross-country context, we selected a peer group of small, advanced economies in Europe with large banking sectors as measured by the ratio of total banking assets to GDP. The peer group includes microstates such as Liechtenstein as well as larger financial centers such as Switzerland (see the chart below). This allows comparing the Andorran banking sector to those in similar countries and draw a few stylized facts:

- The consolidated assets of the Andorran banking sector are €17.5 billion–or 5.5-times Andorra's GDP, at the end of 2022. This places the Andorran banking system around the average of its peers, smaller than in several financial centers in Europe but significantly larger than the Euro area average.
- The financial sector in Andorra contributed to more than 12 percent of the GDP and employed about 4 percent of the labor force in 2022. For comparison, in Switzerland, the contribution of the financial sector to GDP is about 9 percent while its share of employment is about 5 percent, while in Liechtenstein, the corresponding figures are a 20 percent share of GDP and a 17 percent share of employment.

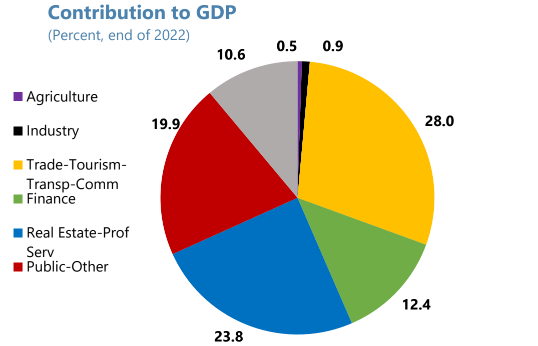
[1] Prepared by Aidyn Bibolov. The author thanks Rodolphe Blavy and seminar participants in Andorra for their comments and Yueshu Zhao for her research assistance.

*The ratio of bank assets to GDP exceeds the Euro area average but is smaller than for some peers.*




Sources: Andorran Financial Authority, FSI, and IMF staff calculations.

*The financial sector is the fourth most important sector in the economy.*




Sources: Govern d'Andorra Statistics Department and IMF staff calculations.

**2. Compared to peers, Andorran banks operate in a different regulatory and institutional environment—and tend to self-insure through large prudential buffers.**

- *A different banking landscape:* Only 3 banks operate currently in Andorra after several mergers. All banks are majority privately owned by local families. This is different from peers where foreign banks are present. Andorran banks are banking groups that consist of diversified financial services companies in Europe, Latin America, and the U.S. Some banks have ownership in real sector companies in Andorra.

- *A different institutional framework*: After signing a Monetary Agreement with the EU in 2011, Andorra adopted the euro but does not have a central bank. Thus, Andorran banks do not have direct access to a national central bank or to ECB refinancing facilities unlike banks in peer countries. Introduction of the lender of last resort facility in 2022 helps to alleviate liquidity risks by providing a backstop for a solvent, but temporarily illiquid bank, but is unlikely to change bank holdings of significant liquidity buffers as a self-insurance.

- *Solid prudential positions*: To compensate for limited financial safety nets, Andorran banks have been traditionally holding solid capital buffers. As of 2023Q3, the system-wide total capital and Tier 1 ratios were 16.3 percent and 15.6 percent, respectively.[2] Liquidity buffers are significant. As of 2023Q3, the system wide LCR ratio was 200 percent, significantly above the regulatory minimum of 100 percent.

**3. The primary focus of Andorran banks is on private banking.** Their assets under management (AUMs), held primarily off-balance sheet, have been growing consistently, reaching €64 billion- or 20-times GDP in 2022, making them much larger than on balance sheet total assets,[3] with private clients mostly in Andorra and Spain, and some subsidiaries in other countries in Europe

---

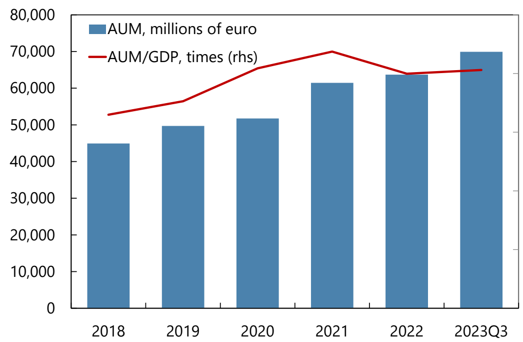
[2] Unless otherwise stated, in the remainder of the paper we use consolidated data for banks. Data for 2023Q3 is preliminary and not audited.

[3] Weaker equity markets and a substantial increase in nominal GDP in 2022 contributed to the decline in the ratio from the peak in 2021.

and in Americas. By the ratio of AUMs to GDP, Andorran banks are the third largest group among their peers.

*AUMs have been growing in Andorra…*

**Assets under Management, 2018-2023**

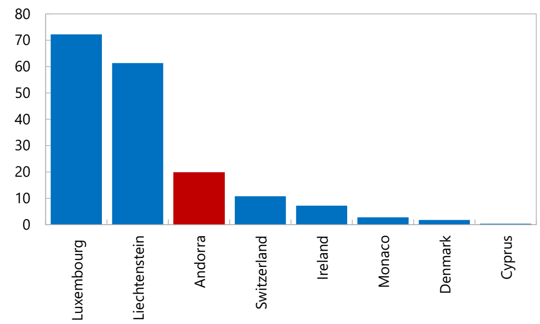



Sources: Annual bank reports and IMF staff calculations.

*…placing the country in the top 3 of its peer group.*

**Bank Assets under Management to GDP**

(times, latest available)



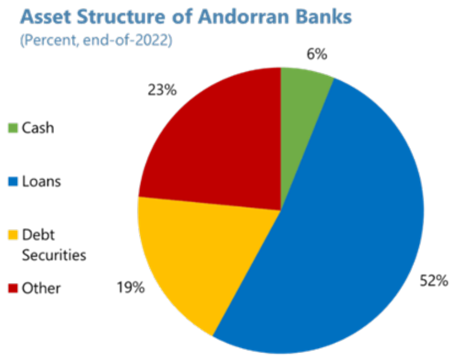

Sources: S&P, and IMF staff calculations.

**4. Commercial banking activities are significant, benefiting from interest rates increases, and driving high profitability**. About half of Andorran on-balance sheet bank assets were in loans, a fifth in debt securities, and 6 percent in cash at the end of 2022. Domestic credit is primarily allocated to private companies and households. Domestic loans to the government are small as the central government switched to borrowing externally from 2020. Substantial commercial banking differentiates Andorra:

- *Andorra is leading its peers on domestic credit…* Credit to the private sector to GDP, at 190 percent, is the highest compared to the peer group, even after a recent substantial decline from the peak in 2020. About 41 percent of those loans are given to non-residents (majority of which are short-term loans to foreign banks to manage liquidity), explaining part of the high level of credit to the economy.

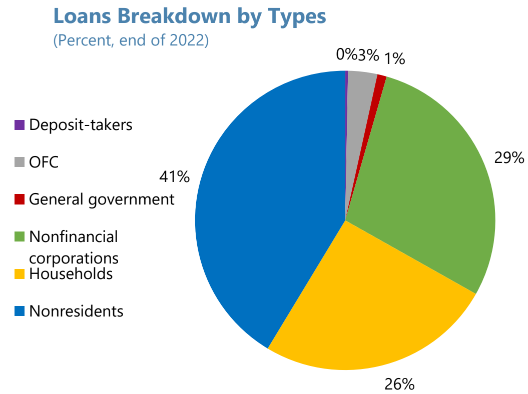
- *… and also on profitability, benefiting from interest rates increases*. Andorran banks led their peer group in 2022 with the ROA of 0.6 percent and the ROE of 6 percent, though they were below the EU average by ROE. Net fees and commissions have historically represented more than half of the total operating income for Andorran banks, while net interest income share was about 20 percent. More recently, interest rates increases boosted net interest margin, to account for an estimated half of operating income in 2023. This development reflects the relative importance of commercial banking for Andorran banks—a useful diversification of activities.

*Assets are primarily in loans and debt securities.*[1]



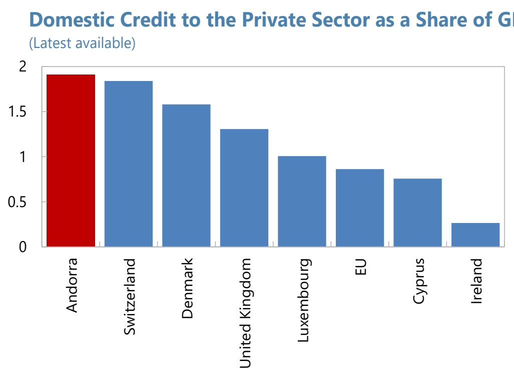

Sources: Crèdit Andorrà Group, Andbank Group and Morabanc.

*Loans to nonresidents, companies and households dominate the credit portfolio*



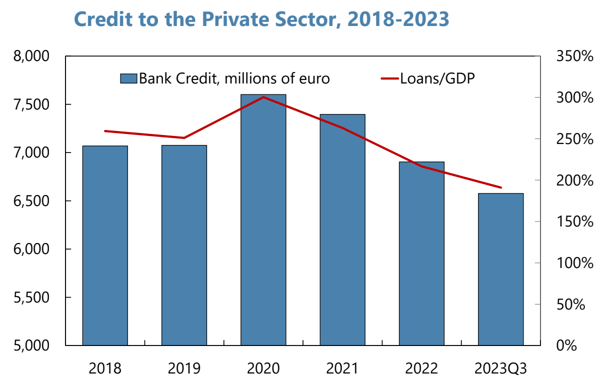

Sources: FSI, and IMF staff calculations.

*Andorra has the highest credit to GDP ratio in the peer group…*




Sources: World Bank, AFA, and IMF staff calculations.

*… even after credit has declined in Andorra in recent years.*

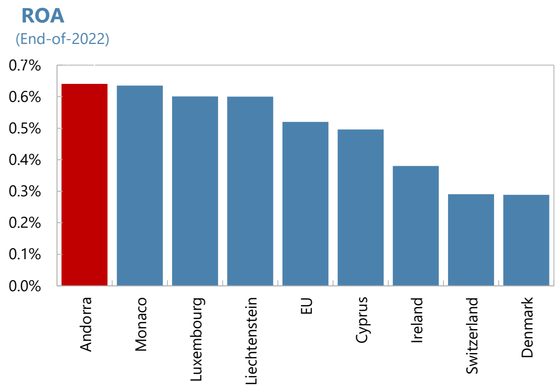



Sources: AFA, and IMF staff calculations.

[1] We use data from the Andorran Financial Authority (AFA) when available. For some charts, we use data from the Andorran Banking Association (ABA) and annual bank reports as indicated. There could be small variations in data due to that.

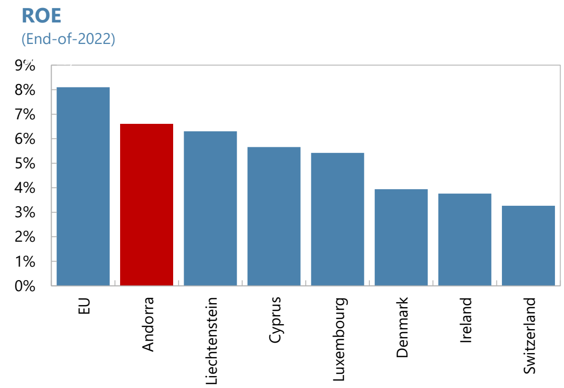
5. **Similar to peers, Andorran banks operate with relatively high-cost structures which reflects their model**. Private banking involves high costs due to the personal nature of the operations and the need to maintain a physical presence in the markets served. With the cost-to-income ratio between 70 and 85 percent, Andorran banks are somewhere in the middle of their peer group as a whole and are similar to other private banks.

*Andorran banks lead the peer group by return on assets …*



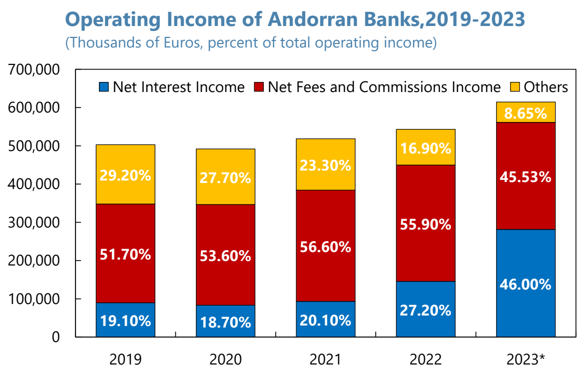

Sources: FSI, and IMF staff calculations.

*… and by return on equity.*



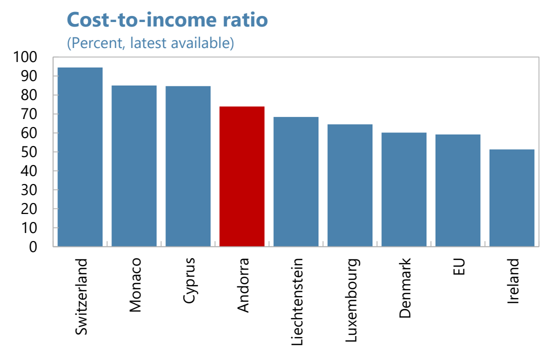

Sources: FSI, and IMF staff calculations.

*Net interest income share has increased on the back of the rising rates.*




Sources: Annual bank reports, ABA, and IMF staff calculations.
Note: 2023 data is an estimate based on unaudited and preliminary 2023Q2 data.

*Banking system's cost-to-income ratio is similar to peers*

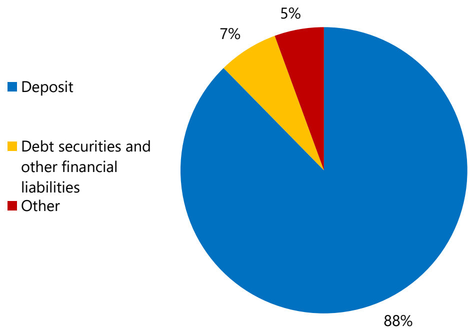



Sources: WBDI, FSI, and IMF staff calculations.

6. **Andorran banks rely almost exclusively on deposits for funding, including a large share of foreign deposits.** Deposits account for almost 90 percent of funding. One third of deposits comes from nonresidents, and those are mostly related to the banks' private banking activities. These deposits are typically tied to investments and tend to be sticky, only liquidated together with assets. Banks in Andorra rely significantly less on debt securities and other sources of funding compared to the EU average, where commercial banking dominates overall. Another reason for the low reliance on debt is the high structural liquidity of Andorran banks. This has allowed them to finance growth without much borrowing.

*Deposits account almost all funding to Andorran banks …*

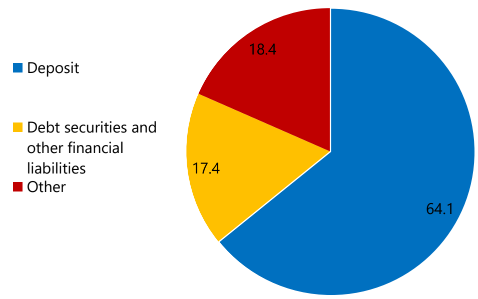
**Sources of Funding of Andorran Banks**
(Percent of total liabilities, end-of-2022)




Sources: Annual bank reports and IMF staff calculations.

*… while their average share in the EU is two-thirds.*

**Sources of Funding of EU Banks**
(Percent of total liabilities, end-of-2022)




Sources: EBA Dashboard, and IMF staff calculations.

**7. Growth in the banking sector has mostly been focused on new markets abroad and new sources of revenue.** Given the small domestic market, banks have been actively expanding operations abroad over the past decade, primarily via private banking and asset management services in Europe and Americas where most AUMs are located. Andorran banks receive a significant share, sometimes a majority, of their profits from international operations. Expansion abroad allows diversification but exposes banks to market-specific risks in other countries.[4] Subsidiaries abroad are subject to host countries' regulations and supervision, and in euro area countries, have access to ECB liquidity facilities.

## B. Determinants of Private Banks Profitability

**8. To better understand the determinants of Andorran banks' profitability, we look at a larger dataset of banks, with a focus on private banking.** Stylized facts suggest that Andorran banks, as private banks, have higher costs than purely commercial banks, yet benefit from a relatively more diversified portfolio of activities compared to their peers. Our dataset comprises annual financial statement data for banks that manage wealth (private banks thereafter) from 2013 to 2022 from the Fitch database. There are 275 private banks from 39 countries in the sample, including 5 banks from Andorra (3 existing and 2 that existed before). Most of the banks are from the U.S., Switzerland, and the U.K. While the topic of bank profitability has been covered before, [5] there is limited evidence about the determinants of profitability specifically for private banks.

**9. We use a combination of bank-specific and macroeconomic variables.** To capture profitability, we use the return on average assets (ROAA) and the return on average equity (ROAE). We use a combination of bank-specific and macroeconomic variables as explanatory variables. Bank-specific variables include bank size (logarithm of total assets) and capitalization (equity to assets). Macroeconomic variables are real GDP growth and interest rate (for the corresponding reference short-term sovereign notes lagged by one period). In line with previous literature, we

[4] See Berger et al. (2016).

[5] For example, see Al-Homaidi et al. (2018), Kohlscheen et al. (2018), and N. Petriaa et al. (2015).

expect capitalization, GDP growth, and interest rate to be positively associated with bank profitability. The literature is ambiguous on the impact of asset size. For private banks, the common wisdom is that larger size drives profitability due to the economies of scale and positive externalities associated with size (reputation, market share), and we take this as our hypothesis.

**10. Size, capital, economic growth, and interest rate are positively associated with bank profitability.** The results of the regressions are presented in Table 1. All explanatory variables have expected signs.[6] Higher interest rate and capitalization are significant for both measures of profitability. Real GDP growth rate and bank size are significant for the ROAA. The findings confirm the assumptions that larger size is associated with greater profitability and that better capitalized banks are more profitable. These two factors depend on banks and the strategies they pursue. Real GDP growth and interest rate are exogenous to banks and can serve as signals for regulators on the direction of bank profits.

**Table 1. Andorra: Determinants of Private Banks Profitability**

| Variables | ROAA | ROAE |
|---|---|---|
| **log Total Assets** | 0.302** | 0.129 |
| | (0.026) | (0.605) |
| **Equity/Total Assets** | 0.118*** | 0.07*** |
| | (0.000) | (0.000) |
| **Real GDP growth** | 0.304** | 0.352 |
| | (0.02) | (0.143) |
| **Lagged interest rate** | 0.692** | 2.263*** |
| | (0.049) | (0.000) |
| **Constant** | 0.925 | 3.664* |
| | (0.413) | (0.077) |
| **Observations** | 1,919 | 1,919 |
| **Adjusted R-squared** | 0.166 | 0.022 |
| **F statistic** | 94.9 (0.000) | 11.74 (0.000) |

## C. The Road Ahead for the Andorran Banking System

**11. Understanding the specificities of the Andorran banking system is important to better capture financial sector risks. This is particularly important given the systemic nature of the banking sector in Andorra.** With total assets 5.5 times the country's economy, consolidated assets of each bank exceed GDP. In general, the literature suggests that private banking is characterized by lower credit risks since loans are collateralized; market risks from investments are primarily on the

[6] The relatively low R-squared values are common in cross-country banking regressions.

clients' side; and therefore, the main risks lie in compliance, reputational, and operational risks. This was illustrated in Andorra with the failure of Banca Privada d'Andorra (BPA) in 2015. Given the small nature of the internal market, there is concentration and related party risk in bank portfolios, though these exposures have been decreasing over the past years.

**12. The status of the microstate and lack of a central bank necessitate a specialized approach to banking regulation, supervision, and resolution.** Andorra has been developing its regulatory and supervisory framework by moving closer to the EU standards—the process that was facilitated through the signing of the Monetary Agreement with the EU in 2011. The Andorran Financial Authority (AFA) is a financial sector supervisor and regulator established in 1989 responsible for all financial institutions in Andorra. The AFA does annual and thematic on-site inspections of the three banks and had a staff of 25 people at the end of 2022. Andorra adopted a capital conservation buffer, a capital buffer for systemically important institutions, and a countercyclical capital buffer for its banks. The Financial Intelligence Unit of Andorra (UIFAND) was created in 2000 as the authority in charge of the AML/CFT issues. The AFA and the UIFAND are members of international organizations and cooperate with supervisors in countries where Andorran banks operate. The Agency of Resolution of Banking Entities was created in 2015 and is responsible for recovery and resolution of banking institutions. Together, the three institutions comprise the system of regulators that oversee the banking system of Andorra.

**13. Lessons from past crises call for a solid institutional, regulatory, and supervisory framework.** Lessons from other economies with large banking systems that underwent periods of stress during the global financial crisis of 2008-09 are presented in Box 1. Andorra has factors in place that mitigate risks coming from its large banks: solid capital ratios, ample liquidity, comfortable profitability, solid macroeconomic country performance and prudent policies. The authorities have strengthened the AML/CFT framework with a new AML/CFT law, closer cooperation between the UIFAND and international organizations, and enhanced coordination in joint inspections between the AFA and the UIFAND.

### Box 1. Andorra: Lessons from Countries with Large Banking Systems[1]

Banking systems in Hong Kong SAR, Iceland, Ireland, Singapore, and Switzerland grew significantly in the run up to the global financial crisis (GFC) of 2008 with the banking assets reaching between 600 and 900 percent of their countries' GDP by 2007. Despite different experiences during the GFC, common themes are summarized below:

- Rapid asset growth, high reliance on foreign and wholesale funding, and aggressive expansion abroad were among the factors that led to major banking crises in Iceland and Ireland.
- More stringent regulation, such as a lower LTV ratio prior to the crisis helped to cushion banks from a subsequent decline in house prices.
- Countries with a "hands on" supervision in place before the crisis had better experience during the crisis and their banking systems better coped with the stress.
- Subsidiarization of foreign operations helped to reduce spillover risks to the bank groups and their home countries. In contrast, banks that expanded via branches faced higher contagion risks to their groups and home countries.
- Guarantees of banking liabilities transferred risk to sovereigns. This phenomenon was very well evident in Iceland and Ireland leading to a prolonged resolution of banking crises and recessions that accompanied them in countries.
- Maintaining strong fiscal and external buffers prior to the crisis helped countries to deal with stress in financial markets.
- Sovereign liquidity swap lines with major money centers helped to provide liquidity to the affected banking systems when needed.

[1] Based on the IMF (2010). Cross-Cutting Themes in Economies with Large Banking Systems.

**14. The recently agreed EU Association Agreement may open up opportunities to access new markets for banks.** The financial sector of Andorra has a 15-year transitional period during which to bring financial sector legislation, supervision, and regulation in line with those of the EU. Each of the four financial subsectors are covered – banking, insurance, asset management, and securities market. The Association Agreement provides an opportunity for banks to expand into the single market more easily and at lower compliance costs using the passporting system. The Liechtenstein example, which grew significantly after signing its EU Association Agreement, [7] provides a useful precedent for Andorra (Box 2). The opportunity to diversify abroad further is valuable as the domestic economy is volatile and exposed to climate change in the medium-term. The possibility for European banks to enter Andorra under the same conditions could lead to significant changes to the domestic financial sector structure. While Andorra has made significant progress in harmonizing its banking regulation with the EU under the Monetary Agreement, a substantial scope of work remains.

[7] See Liechtenstein (2020), and Pelkmans and Böhler (2013) for more details.

**Box 2. Andorra: Association Agreement with the EU: Lessons from the Liechtenstein Experience**

Liechtenstein is a microstate with similarities to Andorra, as a small mountainous country landlocked between Switzerland and Austria where the financial sector plays a big role in the economy. Like in Andorra, banks in Liechtenstein primarily specialize in private banking and three local banking groups dominate the sector, each of them being systemic due to its size. At the same time, Liechtenstein is a more diversified economy with substantial industrial production.

Liechtenstein signed an Association Agreement with the EU in 1992 and joined the European Economic Area in 1995. Under the agreement, Liechtenstein banks have access to the EU internal market via the passporting regime, allowing them to offer their (mostly wealth management) products directly to customers in the EU.

Liechtenstein retained its Financial Market Authority as the supervisor of its banks. Liechtenstein adopted the Swiss franc as a currency under a treaty with Switzerland in 1980. Under the treaty, the Swiss National Bank plays a central bank role for Liechtenstein, including providing access to refinancing facilities to its banks. Liechtenstein has 12 banks, mainly operating in the asset management industry.

Since joining the EEA in 1995, Liechtenstein was able to provide its financial sector with growth opportunities beyond the country while integrating its financial sector framework with the EU and becoming a key center for investment funds, while preserving provision of financial services and the domestic financial system. In 2022, Liechtenstein banks' assets under management reached 411 billion Swiss francs, or about 60 times the country's GDP, among the largest in the world.

## D. Policy Implications

**15. Diversification helps to stay competitive.** Evidence shows that Andorran banks are large, notably in terms of AUMs from their private banking activities, but also important financial intermediaries in the domestic economy. Andorran banks are actively expanding abroad to diversify revenues, but this exposes them to foreign macroeconomic and other risks. Andorran banks keep high liquidity that signals their strong position and acts as self-insurance given the absence of a direct access to a central bank liquidity facility. The relative diversification of the Andorran banks between private and commercial banking activities allows them to balance their performance over changes in market conditions.

**16. Proactive supervision and use of the macroprudential tools to contain the risks.** Experience of other countries with large banking systems suggests that a close and proactive supervision using macroprudential tools is necessary to contain the risks. Given the size of Andorran banks, keeping substantial capital and liquidity buffers by banks is a prudent strategy. Besides signaling solid solvency, higher capitalization is associated with higher profitability as shown by our empirical investigation. Activation of the countercyclical capital buffer by the AFA to 0.5 percent from Oct 1, 2024, is timely given that the economy is growing above potential, allowing to build buffers in good times. Given the 2023 banking stress experience in the U.S. and Europe, it is important to strengthen the recovery and resolution process in Andorra. Implementing of the EU Bank Recovery and Resolution Directive will further strengthen the supervisory framework in Andorra.

**17. Expanding capacity to take advantage of the opportunities and answer future challenges.** The Association Agreement with the EU is a test for banks and supervisors. Over the course of the transition period, banks need to prepare for greater competition, while the supervisors have to bring the Andorran financial sector regulation in line with the EU. The AFA should prepare by working together with banks to help them transition to the new environment. As size is associated with profit in the private banking industry as well as a potential consequence of the Association Agreement, Andorran banks are likely to grow further to compete with foreign banks. The AFA's resources, notably its staffing, will need to be expanded to supervise the transition but also what is likely to become an even larger financial sector in the country. Continuing financial and macroeconomic stability during and after the transition period will be key.

# References

E. Al-Homaidi, Tabash, M., Farhan, N., and Almaqtari, F., Bank-specific and macro-economic determinants of profitability of Indian commercial banks: a panel data approach, Cogent Economics and Finance, 2018, 6:1, 1548072.

Berger, A. N., El Ghoul, S., Guedhami, O., & Roman, R. A., Internationalization and Bank Risk. Management Science, 63(7), 2283–2301, 2016.

IMF, Cross-Cutting Themes in Economies with Large Banking Systems, 2010.

E. Kohlscheen, Murcia A. and J. Contreras, Determinants of bank profitability in emerging markets, BIS Working Papers, January 2018, No 686.

Liechtenstein, Bericht und Antrag der Regierung an den Landtag des Fürstentums Liechtenstein betreffend 25 Jahre Mitgliedschaft des Fürstentums Liechtenstein im Europäischen Wirtschaftsraum (Report on twenty fifth anniversary of EEA membership), Nr. 34/2020.

J. Pelkmans and P. Böhler , The EEA Review and Liechtenstein's Integration Strategy, Centre for European Policy Studies, 2013.

N. Petriaa, N., Caprarub, B., and Ihnatovc I., Determinants of banks' profitability: evidence from EU 27 banking systems, Procedia Economics and Finance, 2015, 20, 518–524.