

Appendix I. Letter of Intent

Kyiv, June 2, 2020

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Ms. Georgieva:

1. Since the deep economic crisis of 2014–15, Ukraine, with strong support from the international community, had been able to achieve macro-economic stability and restart growth. Economic vulnerabilities had been reduced, as tight fiscal policies had placed government finances on a sound footing and public debt on a downward path. Sound monetary policies and the adoption of a flexible exchange rate regime restored competitiveness, improved our external position, and allowed the National Bank of Ukraine (NBU) to rebuild its foreign exchange reserves.
2. After last year's presidential and parliamentary elections, our aim was to continue sound macro-economic policies and advance structural reforms, that would deliver higher, sustainable and inclusive growth and allow incomes in Ukraine to catch up with the levels seen elsewhere in the region.
3. As all other countries, Ukraine is now being hit hard by the COVID-19 pandemic, and the resulting decline in global activity and trade, as well as the closure of capital markets. We have taken drastic, but necessary, steps to contain the spread of the virus. Starting on March 13, 2020, we have taken extensive measures to protect our population's health and support our economy. Ukraine entered this crisis with strong macro-economic fundamentals and fiscal and financial buffers. Nonetheless, the toll this crisis is taking on our economy, combined with the decline in trade and in remittances, is without precedent in modern history.
4. We have focused our policies on saving people's lives and livelihoods and ensuring that our economy recovers quickly when the crisis subsides. We are temporarily relaxing our fiscal and financial policies, to absorb the impact of the shock, while aiming to maintain macroeconomic and financial stability. Key priorities are to step up public spending to meet urgent healthcare needs, and to provide additional resources to protect employment and viable businesses and increase social assistance to protect the most vulnerable households and the elderly. We are committed to ensuring strong control, audit, reporting, and transparency with respect to all crisis-related government spending. Our monetary and exchange rate policies aim to ensure an orderly exchange rate adjustment in response to the shock and to prevent liquidity distress. This is supplemented by our financial sector policies that aim to strike a balance between preserving financial stability and sustaining economic activity. The attached Memorandum of Economic and Financial Policies (MEFP) describes our goals and policies in more detail.
5. In addressing the crisis, we continue to focus on the pre-conditions for increasing incomes through higher growth. Our macro-economic policies will continue to be aimed at

preserving medium-term fiscal sustainability, safeguarding central bank independence and maintaining stable inflation; and safeguarding financial stability, while minimizing the costs to the state—and hence to the taxpayers—stemming from bank resolution decisions. We will continue to strengthen the rule of law and tackle corruption, including by ensuring the effectiveness and independence of our new anti-corruption institutions. We are also committed to creating a level playing field and reducing the role of the state and vested interests in the economy, including by safeguarding and advancing corporate governance reforms in our state-owned enterprises and banks.

6. To support our efforts, we request an 18-month Stand-By Arrangement (SBA) in the amount of SDR 3.6 billion (178.9 percent of quota and equivalent to about US\$5 billion) for balance of payments and budget support. We commit to put in place a memorandum of understanding between the NBU and the Ministry of Finance that clarifies the responsibilities for timely servicing of the financial obligations to the IMF. Together with our policies, this new arrangement will help cover Ukraine’s urgent balance of payments and fiscal needs, in support of our emergency crisis response. The new arrangement will build upon progress made under the previous IMF-supported programs and provide a valuable anchor for our economic policies. The new program will also continue to play a catalytic role in mobilizing international support, notably from the EU and the World Bank, to ensure that the program is fully financed, and in helping to ensure continued access to international capital markets as global market conditions permit.

7. We have already taken numerous steps toward achieving our goals, including by adopting a revised budget for 2020, reflecting the crisis-related loss in revenues and the additional spending needs. We have also passed and enacted several pieces of important legislation. Specifically, we have already taken the following prior actions:

- We have enacted amendments to the customs and tax codes and other laws to enable the elimination of the regional tax and customs offices as independent legal entities and thereby the creation of the Tax and Customs Services as single legal entities (paragraph 8b of the MEFP);
- We have enacted amendments to the banking law, the law on the Deposit Guarantee Fund (DGF) and the code of administrative justice to ensure that courts defer to the NBU’s, the DGF’s and the Ministry of Finance’s expertise and discretion in bank resolution matters (including provisional administration and liquidation) and cannot reverse banks resolutions decisions, allowing only compensation, limited to proven losses, as a remedy if warranted (paragraph 22 of the MEFP);
- We have adopted a contingency plan to mitigate potential risks posed to financial stability and public finances by adverse court rulings against past resolution decisions (paragraph 23 of the MEFP);
- We have enacted legislation to re-criminalize illicit enrichment consistent with international standards and Ukraine’s Constitution (paragraph 25a of the MEFP);
- We have enacted amendments to the AML law consistent with FATF standards (paragraph 25f of the MEFP); and

- We have lifted the cap on household heating tariffs (paragraph 27b of the MEFP).

8. Based on these steps and our commitments for the period ahead, we request approval by the IMF Executive Board of the proposed SBA. We also request that the IMF Executive Board approves to make available SDR 1.5 billion (74.6 percent of quota, equivalent to about US\$2.1 billion) upon approval of the arrangement. We furthermore request approval of the retention of the exchange restriction and multiple currency practices that we maintain temporarily due to balance of payments difficulties and that are inconsistent with our obligations under Article VIII Sections 2 (a) and 3 of the Fund's Articles of Agreement. During the period of the SBA, Ukraine will not introduce or intensify exchange restrictions, introduce or modify multiple currency practices, and will not introduce or intensify import restrictions for balance of payments reasons nor conclude bilateral payment agreements that are inconsistent with article VIII of the Fund's Articles of Agreement.

9. The program will be monitored through four reviews, and Table 1 of the attached MEFP presents the quantitative conditions (periodic and continuous performance criteria, indicative targets) and a monetary policy consultation clause, while Table 2 describes the structural benchmarks under the program. The four reviews are expected to be completed on or after September 1, 2020, December 1, 2020, May 15, 2021, and October 15, 2021, respectively.

10. We believe that the policies set forth in the attached MEFP are adequate to achieve the macroeconomic and financial objectives of the program, but we will take any additional measures that may become appropriate for this purpose. We will consult in advance with the IMF on the adoption of these measures and on any revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such consultation. We will refrain from policies that would be inconsistent with the program's objectives. We will provide IMF staff with the data and information it requests for the purpose of program monitoring. Reaffirming our commitment to transparency, we consent to the IMF's publication of this letter, the MEFP, the Technical Memorandum of Understanding (TMU), and the accompanying Executive Board documents immediately upon consideration of our requests by the IMF's Executive Board.

Yours sincerely,

/s/

Volodymyr Zelenskyy
President

/s/

Denys Shmyhal
Prime Minister

/s/

Sergii Marchenko
Minister of Finance

/s/

Yakiv Smolii
Governor, National Bank of Ukraine

Attachment I. Memorandum of Economic and Financial Policies

May 28, 2020

1. Our policies are focused on effectively tackling the health emergency caused by COVID-19 in the short run, while maintaining macroeconomic stability, reducing vulnerabilities, and achieving stronger and inclusive economic growth in the medium run. As the crisis resulting from the COVID-19 outbreak intensified and the macro-economic outlook worsened, we have swiftly adopted an emergency fiscal package aimed at reorienting expenditure toward healthcare and social support to address the immediate needs. For the medium term, we remain committed to preserving the achievements realized since the economic crises of 2014–15. Our policies are centered on: (i) continuing with sound fiscal policies to ensure medium-term debt sustainability, while improving spending outcomes and protecting the poor, and strengthening revenue administration; (ii) ensuring central bank independence, maintaining a cautious monetary policy to keep inflation low and rebuilding reserves in the context of a flexible exchange rate regime, while ensuring banks' financial health, minimizing fiscal costs from bank resolutions, and reviving sound bank lending; (iii) firmly establishing the rule of law and tackling corruption; and (iv) enhancing competition by opening up markets, creating a level playing field, and reducing the role of the state and vested interests in the economy to improve the business environment, attract investment and raise the economy's potential.

A. Fiscal Policies

2. In the short term, fiscal policy is focused on addressing the emergency caused by the COVID-19 outbreak, while in the medium term it will continue to be directed at ensuring fiscal sustainability. After allowing the deficit to widen in 2020, we will progressively tighten fiscal policy as the economy recovers to return to primary budget surpluses of around 1–1½ percent of GDP with a view to reduce public debt to around 60 percent of GDP by the end of the program. More specifically:

- a. **2019 Budget.** We kept the general government budget deficit below the target of 2.3 percent of GDP. Budget execution has been broadly in line with the approved budget. A shortfall in some revenue categories, notably lower revenues from VAT, royalties and excise on imports and customs duties, due to a stronger exchange rate and lower international gas prices, were partly offset by higher personal income tax and social security contributions owing to strong wage growth, higher revenues from state-owned enterprises (SOEs), as well as by savings in debt servicing due to improved liquidity management by the Ministry of Finance and the stronger exchange rate. A supplementary budget was adopted to formalize these adjustments. Similarly, higher-than-budgeted pension spending was compensated by the higher social security contributions as well as new custom clearance procedures for cars with foreign registration.

- b. **2020 Budget.** The 2020 budget adopted by parliament in late 2019 as a **prior action** was consistent with a general government budget deficit of 2.3 percent of GDP, as projected at the time of budget approval. This budget included no major changes in tax policy, other than the already scheduled increases in excise rates on tobacco products and the legalization of amber extraction. The increase in the payroll fund for civil service was limited to 5.3 percent in 2020 and the minimum monthly wage was raised by 13.2 percent to UAH 4,723. Pension benefits, including for military and other special pension schemes, were budgeted to increase in accordance with the provisions of the pension reform law adopted in 2017. Separately, we have also increased the effective taxation of iron ore and effective from January 1, 2021, we have also harmonized the taxation of heated tobacco products with that of traditional tobacco products.
- c. **2020 supplementary budget.** Since the approval of the budget, the macro-economic outlook has worsened dramatically due to outbreak of the COVID-19 virus. To respond to this emergency, we have adopted a supplementary budget (**an update to the prior action**), which allows the deficit of the general government to expand to UAH 300 billion (about 8 percent of GDP), taking into account the large fall in revenues due to the decline in activity, as well as the additional spending needs to respond to the crisis. On the revenue side, the fiscal package provides support to households and small entrepreneurs by raising the thresholds for businesses to qualify for the simplified tax regime, a temporary exemption from tax fines and penalties for delays in filing tax returns, land and property taxes, and the unified social tax; as well as through a temporary moratorium on tax audits and inspections. Medicines and medical devices used to prevent or combat COVID-19 infections have been exempted from import duties and VAT. On the expenditure side, expenditures on health care, pensions, and social protection were increased by about 3 percent of GDP, partially offset by a reduction in capital and non-priority current expenditures. A temporary cap was introduced on all public sector wages and salaries, including those in other state bodies and state-owned entities. This cap is to be lifted by end-June, as containment measures are gradually eased. Should further burden-sharing be needed, we will explore other mechanisms for efficient redistribution. The increases in pensions will take the form of: (i) an advanced date of indexation of pensions, and (ii) one-off additional pension payments to low-income pensioners and elderly pensioners (80 years or older). To administer these expenditures the government has created a temporary budget program, the fund for COVID-related spending.
- d. We expect that improvements in tax and customs administration will yield some higher than budgeted revenues in the course of the year but were revenues to underperform we will curtail non-priority spending as needed, to ensure that the deficit target will not be exceeded. Any revenue over-performance will be used to reduce public debt, settle arrears, increase infrastructure investment, or to raise social benefits to improve living standards of the most vulnerable. We will remain current on all our payment obligations and not accumulate any spending arrears. We will work with IMF staff to develop in 2020 proposals to reform our tax system and make the tax system more growth friendly, including by

addressing tax gaps, broadening the tax base, and reducing opportunities for tax avoidance, with a view to shift taxation from direct taxes to indirect taxes and the taxation of wealth. We will not enact any legislation during the program period that changes our tax system such that it will undermine fiscal sustainability. Moreover, during the program period we will refrain from introducing new tax exemptions or privileges (except for the already approved exemptions that are implemented for COVID-related healthcare expenditures), including tax-free zones, and preferential rates and duties, and further earmarking of revenues (except for the expenditure of the fund for COVID-related spending). We also plan to develop together with IMF staff a voluntary disclosure scheme for possible consideration by end-September-2020 that is consistent with international best practices, including fairness vis-à-vis compliant taxpayers, consistency with AML and anti-corruption legislation (such as non-exemption from non-tax offenses and exclusion of politically exposed persons), and including rigorous due diligence procedures, and which will be linked to base erosion and profit shifting (BEPS) legislation that has been adopted recently and demonstrated progress in strengthening tax administration.

- e. **Budget Program for COVID-related spending.** The approved supplementary budget envisions the establishment of the budget program “Fund to Fight Against COVID-19 and its Impact”. We will ensure that this fund will be temporary, transparent and its expenditures efficient. The fund will be used primarily for the purpose of financing additional health care and social expenditures directly related the COVID-19 epidemic. The operations of the fund will be governed by regulations issued by Cabinet of Ministers of Ukraine (CMU) reflecting transparency and accountability requirements. These government regulations will cover: (i) the procedures for re-allocating resources to the fund; (ii) the authorization processes for committing the resources of the fund, allocating a central role to the Minister of Finance; (iii) the budget execution rules that will be followed; (iii) the detailed monthly reporting to be filed with the CMU and parliament on the use of funds in the previous period; (iv) the requirement that all cash transactions of the fund have to be executed through and reported by the Treasury; (v) the rules for discontinuing the operations of the fund, including the use of any remaining resources and responsibility for commitments active at the time of the fund’s closure. An ex-post procurement audit of the COVID-19 program will be conducted by the State Audit Service of Ukraine, in consultation with external/third party auditors, of all transactions conducted under the rules of CMU resolution 302 at the time of closing the fund but no later than 12 months after its establishment (a **structural benchmark** for end-March 2021). We will also prepare a detailed progress report regarding disbursements and commitments of the fund by program and economic classification within 30 days of the Fund’s closure. These reports will be made public, in full, at the time of their completion. Furthermore, we will publish all procurement notices in a manner readily accessible to the general public and will make all purchase orders, including information on beneficial owners of the participating bidding companies, electronically accessible to the public on the ProZorro internet site (<https://prozorro.gov.ua>). The fund will operate only until the emergency situation so requires, but not beyond 31 December 2020.

3. We will continue implementing the pension reform measures introduced in 2017 aimed at providing better pensions while ensuring the financial stability of the pension system. The reform was aimed at protecting the elderly against poverty, decelerating the inflow of new retirees by providing incentives to stay longer in the labor force, applying uniform benefit rules irrespective of professional background, and providing incentives for participation and contribution compliance. We will refrain from: (i) introducing new special pensions or privileges; (ii) providing further discretionary benefit increases; and (iii) adopting changes that would lead to lowering the effective retirement age. We will ensure that any proposed legal amendments that will increase pension expenditures are accompanied by a medium-term fiscal impact analysis and the identification of the commensurate resources. We will strive to ensure that, over the medium term, payments to pensioners approach statistically measured subsistence minima and the dates for annual pension indexation will be specified in the Law on Compulsory Pension Insurance. Furthermore, we will continue our collaboration with our development partners to establish the preconditions that would need to be in place before the introduction of well-regulated privately-managed funded pension schemes.

4. We will improve our social assistance programs to create a well targeted (means-tested) and affordable social safety net that can effectively support poor and vulnerable households. With the assistance of the World Bank, we are planning to: (i) consolidate selected existing assistance programs into our guaranteed minimum income (GMI) scheme, while increasing the size of the program; (ii) combine the GMI program with active labor market policies; (iii) implement improvements to the management information system to enhance the verification of beneficiaries of social programs to improve targeting. We will also take further steps to ensure the sustainability of the social funds, including by streamlining the administration of these funds.

5. The implementation of the health care reform will proceed in 2020 by expanding the new mode of financing to secondary and specialized care. Health care financing reform [has] been rolled out on April 1, 2020, expanding strategic purchases of healthcare services by the National Health Service of Ukraine (NHSU) to emergency, intensive and specialized care. The NHSU—a government executive agency funded by the state budget—will function as a single payer in public health care and will closely monitor service delivery and financial performance of providers. Health care providers' gradual transformation into municipally owned non-profit legal entities will continue and their financing will be based on performance contracts concluded with the NHSU. We will complete the delineation of a defined, NHSU-financed package of health services, including primary, specialized, palliative and emergency care, and control demand through financial incentives to service providers, while allowing for the possibility to introduce co-payments for patients if needed, while ensuring that the accessibility and quality of services improves. To ensure that NHSU purchases deliver best value for the patients, the NHSU decision making will be transparently protected from conflict of interest, in particular by excluding participation of service providers in its governance structures. The Ministry of Health will continue to outsource the procurement of key pharmaceuticals to reputable international organizations. Starting in 2020, the Ministry of Health will start piloting the centralized procurement of medicines through the newly created state-owned enterprise Medical Procurement of Ukraine, using ProZorro in line with the Law on Public

Procurement, while also following best international practices of transparency, accountability, and competition.

6. Once the crisis abates, we will accelerate the reform of the education system. We will continue with the right-sizing of the school network for primary and secondary education, increase capital expenditure to renovate buildings and ensure that schools will have the needed infrastructure. We will start with the reform of curricula and, to align teachers' incentives and keep the system fiscally affordable, we will submit amendments to the law on education to parliament to modify the salary structure. For higher education we will transform the funding system of universities and link salaries to performance.

7. We will continue to improve public financial management. We will strengthen our fiscal framework to facilitate sustainable fiscal adjustment and improve the credibility and predictability of fiscal policies. The amendments to the budget code approved in late 2018 have paved the way to our first full-fledged medium-term budget framework (MTBF). We are fully committed to improve our MTBF to reinforce fiscal discipline, facilitate informed policymaking, improve monitoring of commitments, and provide predictability in planning and executing budgets. To this end, together with IMF technical assistance, we will: (i) clarify the mechanisms for adjusting expenditure ceilings, (ii) review the arrangements which limit multi-annual commitments, (iii) improve the methodology to produce forward baseline estimates and fiscal impact assessments especially through capacity building both within the Ministry of Finance and in key spending units. We will expand the coverage and strengthen the quantitative analysis of spending reviews based on the pilot projects conducted in 2018-19. In particular, we will conduct a review of the social funds, including the Pension Fund. We will improve the assessment of fiscal risks by developing the necessary tools within the Ministry of Finance and by expanding our financial model to include major SOEs. To increase the efficiency of government investments we will consider ways to simplify the authorization procedure for multi-year contracts and the carryover of unspent appropriations. We have also amended the budget code to allow pre-financing of the budget deficit. Pre-financing will be subject to limits to preserve fiscal stability in accordance with best practices. We will operationalize the debt management office (DMO) with the aim to improve the institutional capacity to manage public debt and to optimize our debt structure and reduce our financing cost. Strategies, operations and results will be published yearly in the debt management strategy.

8. We are taking decisive steps to improve revenue administration. Specifically:

- a. We have enacted legislation to introduce a single account for tax payments unifying requirements for social security contributions and personal income tax payments, effective January 1, 2021. We have also adopted legislation to establish fiscal accountability for cash receipts issued by participants of the simplified regime, with the mandatory use of cash registers and electronic cash registering, and the possibility for customers to verify tax reporting online, effective January 1, 2021. We will assess the impact of the implementation of this legislation on preventing tax avoidance and abuse of the simplified tax regime, and are taking steps to incentivize SMEs to participate in the universal tax regime. We will refrain from widening the eligibility criteria for the simplified tax regime. We will refrain from

introducing new groups of taxpayers benefiting from a simplified tax regime. We will ensure that the automated system for VAT refunds will continue to operate, while continuing our efforts to detect abuse, referring such cases to the appropriate law enforcement agencies. We will also develop ways to share information on taxes that are due to local budgets (land, property, and personal income taxes) with local governments, to help improve the collection of those taxes. We will furthermore improve the process for the determination of the tax base of land and property taxes.

- b. We have established the State Tax Service (STS) and State Customs Service (SCS) as new legal entities, responsible for tax and customs collection. We [have also enacted] changes in the legislation that remove obstacles to establishing the STS and SCS as the only two legal entities as a **prior action**. This included changes to the Customs Code, Administrative Procedural Code, State Secrecy Law, Labor Code, Public Service Law, Law on Central Executive Bodies, budget legislation, as well as other laws that restrict the authority of delegation and efficient management of operations in STS and SCS. We will develop new organizational structures and frameworks for the delegation of authorities and accountabilities in both organizations as single legal entities (a **structural benchmark** for end-September 2020). This will be immediately followed by a testing period of consolidated legal entities in selected pilot offices of the STS and SCS, also to identify possible additional critical changes to the legislation to achieve the objectives of the reform. Simultaneously, we will liquidate the State Fiscal Service (SFS) and transfer its assets, including IT systems, to the STS and SCS. These changes will be enacted no later than end-December 2020. Starting from January 1, 2021, the STS and SCS will be operating nationally as two single legal entities both comprising of functionally organized headquarters and field offices and the regional and other legal entities of the STS, SCS, and SFS will cease to exist (a **structural benchmark** for January 1, 2021).
- c. We also have set up reform offices in the STS and SCS that have prepared time-bound, measurable STS and SCS reform plans for 2020-22. These plans define reform actions, including modernizing core business processes in the STS and SCS, and the sequencing of their implementation. We have established reform governance arrangements in both organizations, including Reform Steering Committees led by the STS and SCS heads, with monthly reporting on reform progress.
- d. The STS and SCS will fundamentally transform the operations of tax and customs administration. Redundant tax and customs processes that burden businesses and taxpayers with little impact on improving compliance will be discontinued. Other processes will be improved, simplified, and where possible digitalized to reduce the administrative cost imposed on taxpayers, while also helping to improve integrity of both organizations. By end-September 2020, a centralized risk-management unit will be set up in the STS that will select audit cases (including of VAT refund checks) for STS' audit units, which will be based on perceived tax compliance risks. We will abolish the system of planned tax audits by end-September 2020, when tax audit selection will be fully based on risk analyses. The STS has

also increased the internal capacity of the debt settlement department and re-launched the legal department to enhance its ability to collect tax arrears. In this regard, the Ministry of Justice has removed all barriers to the enforcement of decisions on tax debt collection, which were previously blocked, and the executive service has begun to recover tax debts accordingly.

- e. Moreover, with the goal of consolidating the investigative authority of economic crimes into a single investigative body, we will adopt legislation to establish a financial investigative authority effective January 1, 2021. This authority will take over the responsibility for investigating economic, financial, and tax fraud and crimes that resides with the national police, the state secret service, and the tax police, but with the exception of those instances that fall under the jurisdiction of the National Anti-corruption Bureau of Ukraine (NABU). The law will set out clear rules for management selection, internal decision-making, and oversight to ensure operational independence and proper oversight and accountability. The head of the authority will be appointed through an open competition.

B. Monetary and Exchange Rate Policies

9. We remain fully committed to an institutionally strong and independent National Bank of Ukraine (NBU), which is crucial for safeguarding macro-economic as well as financial stability. To this end, we are taking steps to implement the recommendations of the 2019 Safeguards Assessment and we will request IMF technical assistance to review the capital management and profit distribution framework to ensure NBU's financial autonomy and policy credibility, and will strengthen within the upcoming DGF Law amendments the NBU's secured creditor status in the case of bank failures. Further, we will avoid taking any actions that may imply political interference with the NBU's independence (regarding policy decisions, term limits and legal protection of managers and staff). The NBU will continue its flexible inflation targeting (IT) policy, within a floating exchange rate regime, and with a strong focus on maintaining financial stability. A credible flexible IT regime will better anchor inflation expectation, allowing the NBU to better smooth economic cycles and mitigate liquidity stress. We will ensure that this framework remains unchanged including irrevocable inflation targets and principles of monetary policy.

10. Our monetary and exchange rate policies and operations will remain consistent with our commitment to meet the program's international reserve and inflation objectives, as well as ensuring sufficient liquidity. We intend to contain inflation within the NBU's target range of 5 percent +/-1 percentage point, while letting the exchange rate adjust in line with economic fundamentals and purchasing foreign exchange to meet the program's reserve targets. The NBU stands ready to adjust the policy rate to reach its inflation target over a policy horizon of 9-18 months. Progress in meeting inflation targets will be monitored under the program by consultation bands around the central points of our inflation targets (Table 1). If actual inflation falls outside the outer (inner) band, the NBU will consult with the IMF Executive Board (staff) on the reasons for the deviation and policies to return inflation to within the band. The gradual capital control liberalization envisaged in the February 2019 currency law will be carefully sequenced and conditions-based,

without setting specific deadlines for the removal of existing restrictions. The banking system is currently highly liquid, with free liquidity equal to about 30 percent of client liabilities. Nonetheless, as the crisis has tightened financial conditions, the NBU has adapted its operating framework to provide banks with greater liquidity management flexibility, including by increasing the frequency and maturities of liquidity provision tenders, and by expanding eligible collateral. The NBU will continue to closely monitor financial conditions to assess whether other liquidity measures may be needed, while also maintaining sound risk management practices. Ensuring sufficient liquidity should allow banks to function normally and finance the private sector and government at market rates in line with fundamentals.

11. We will take further steps to strengthen the effectiveness of monetary policy and support the development of financial markets. We will strengthen the regulatory framework for financial markets (see below) and continue to work with stakeholders to enhance the efficiency and robustness of money and securities markets, which are important for effective monetary policy transmission.

C. Financial Sector Policies

12. Consistent with our commitments under the Fund-supported programs, we have made considerable progress since 2014 in cleaning up the banking system and closing gaps in the regulatory framework. We have intervened and resolved almost 100 banks since 2014, and nationalized PrivatBank, the largest financial institution. We have increased capital and liquidity requirements, tightened rules for credit risk calculation and improved procedures for assessing bank ownership structures. We have beefed up the regulatory and oversight framework for related-party exposures, developed a risk-based approach for supervision and established a centralized credit registry. Our resolute actions were commensurate to the severity of the banking crisis whose direct fiscal costs are estimated at about 15.7 percent of GDP. Thanks to these stringent actions and rules, as well as improved macro-economic conditions, the banking system has gained strength: weak banks have exited the market and the capital buffers of the remaining have increased, related-party exposures have fallen, and most banks have returned to profitability.

13. We will pursue our efforts to ensure financial stability and limit fiscal costs. Our priorities will focus on: (i) implementing targeted and temporary supervisory policies in response to the COVID-19 crisis; (ii) further strengthening bank capital requirements as the crisis passes; (iii) reducing legacy non-performing loans (NPLs) and recovering assets from resolved banks; (iv) implementing the reform strategy for state-owned banks; (v) improving the Deposit Guarantee Fund's (DGF) financial position; (vi) upgrading the supervisory and resolution framework; and (vii) developing the non-bank financial sector and financial markets.

14. The COVID-19 crisis is also taking a toll on the banking sector, and we are reconsidering our supervisory approach during these exceptional circumstances. Borrowers are already facing difficulty in servicing their loans, and legislation was adopted prohibiting banks to impose additional fees and penalties on retail customers that miss regular payments during the

period of quarantine. The NBU has suspended on-site inspections during the period of quarantine and postponed the introduction of additional capital buffers and the annual stress-testing exercise and encouraged voluntary and prudent loan restructuring where necessary to sectors or firms heavily impacted by the crisis. In applying our corrective measures, we will utilize the flexibilities within the current regulatory framework considering the problems caused by the outbreak. Still, any temporary decline in capital ratios should be accompanied with a credible capital restoration plan. On the other hand, we are not contemplating a relaxation of minimum capital and liquidity requirements, loan classification and provisioning rules, to prevent excessive risk taking and hiding poor underwriting practices and losses. Furthermore, to help absorb potential losses from the crisis, we will ensure that banks revise their 2019 dividend distribution planning.

15. Once the crisis abates, we will conduct asset quality reviews (AQRs) to guide our regulatory and supervisory policies. These reviews will provide better information on banks' asset quality and the size of the capital shortfalls. We will ask undercapitalized banks for a time-bound plan to restore capital adequacy ratios. We will take supervisory measures against banks that fail to implement their action plans. We will resume our efforts to align capital rules with international standards once the crisis has passed and the economy returns to the stable growth path. In this regard, based on the new Banking Law amendments, we will implement the capital conservation buffer and finalize the regulation on new capital structure to meet the Basel capital standard.

16. We will safeguard and advance governance reforms in state-owned banks. The majority-independent supervisory boards for all state-owned banks are now operational, following a selection process that was transparent and consistent with the provisions of the Banking Law on state-owned banks, and the fit and proper assessment was conducted without political interference. We will continue to adhere to these processes for filling any vacancies at the supervisory and management boards of these banks, and we will offer market-based remuneration to attract and motivate highly-qualified Ukrainian and international professionals. By end-July, we will (i) finalize relationship agreements with each state-owned bank to ensure that they operate on a commercial basis without political interference; and (ii) hire staff for the oversight unit in the Ministry of Finance in charge of shareholding management, to operationalize this unit in line with IMF technical assistance recommendations. We will also ensure that each state-owned bank develops a code of ethics that will inter alia clarify the procedures for recommending the dismissal of a supervisory board member in line with article 7 of the Banking Law, include disciplinary processes, and establishes an ethics committee to handle complaints and conflicts.

17. Consistent with the Principles of State Banking Sector Strategic Reforms, we are committed to divesting the state's shares in the state-owned banks. As a first step, the International Finance Corporation (IFC) of the World Bank Group has approved a loan to UkrGasBank, convertible into equity. Additionally, we will ensure that all the triggers for the entry of the European Bank for Reconstruction and Development (EBRD) into the capital of OschadBank will be met by end-October 2020. Furthermore, we will ensure that the state-owned banks remain adequately capitalized and meet capital requirements. The implementation of this will be monitored through Key Performance Indicators (KPIs). We will review, in consultation with international

partners, the Strategy of State-owned banks (to be endorsed by the CMU); the review will include in particular actions to respond to economic shocks caused by COVID-19 pandemic.

18. We are stepping up efforts to address the high level of legacy non-performing loans (NPLs) in state-owned banks. In July 2019, the NBU issued a regulation on the organizational arrangements for the management of problem assets to guide banks on how to deal with their troubled borrowers. In September 2019, we extended for three years the Law on financial restructuring (Kyiv approach), which was set to expire in October 2019. Also, in October 2019, we operationalized the new Insolvency Law enacted in April 2019. In April 2020, the CMU approved a resolution that determines the criteria and conditions for the determination by state-owned banks of instruments to resolve NPLs. We will ensure that state-owned banks develop time-bound and credible NPL reduction plans in line with the NBU regulation on problem assets. The state-owned banks' legacy NPL reduction plans, including the option of taking NPL resolution decisions that could realize final losses, will be endorsed by the shareholder and approved by the Financial Stability Council (FSC) and the NBU (a **structural benchmark** for end-June 2020). The implementation of these plans will be subject to quarterly monitoring by the FSC and the NBU and annual evaluation under the NBU's Supervisory Review and Evaluation Process (SREP) and be part of banks' annual KPIs. While balance sheet repair will help revive lending, we will have set up a working group to identify obstacles to bank lending, including mortgage lending, such as remaining weaknesses in credit rights. The working group will formulate its recommendations and proposed legislative changes as needed, by end-June 2020.

19. We are firmly committed to making tangible progress in reducing the cost of bank failures to the state. Since the scope for the recovery of losses becomes increasingly difficult as time elapses, we will promptly pursue all commercial and legal avenues available to recover assets from failed banks and hold former owners and former managers of failed banks accountable for losses. To that end we have taken or will take the following operational and legal steps:

- a. We recognize the need to improve coordination among the relevant state bodies for asset recovery efforts. The FSC's NPL Working Group on state-owned banks initially gathered with representatives of law enforcement agencies also to discuss broader asset recovery issues. The working group will continue to hold regular meetings to review significant restructuring cases concerning state-owned banks. The NBU and the DGF will continue to coordinate their efforts with the Prosecutor General's Office (PGO) and NABU, including by way of providing necessary documentation (including forensic audit reports) to these bodies without prejudice to their prosecutorial and investigative autonomy. The DGF will also start pursuing the recovery of assets abroad. Addressing the DGF insolvency will create the necessary space and incentives for committing the required resources to engage with reputable legal and forensic experts. Recent amendments allow the DGF to continue realizing the remaining assets of the banks that are close to the end of statutory liquidation timeframe. We will furthermore adopt legal amendments to the DGF and other laws to improve bank liquidation mechanisms, and the recovery of assets as a **structural benchmark** for end-October 2020. These amendments will underscore the DGF's ability to claim damages from related parties without showing a deficit in

the liquidation estate, and subject to a special statute of limitation. Further, the DGF will be authorized to enter into a settlement with related parties only if clear and strong safeguards are in place (e.g., after an independent audit confirms that recovery prospects within a reasonable timeframe are limited without a settlement in view of related parties' financial standing, by adequately protecting the DGF's pre-settlement rights in case of a breach, including via collateral, and by transparently informing the public on such agreements). These amendments will facilitate interim measures against related parties during civil lawsuits and recognize the DGF's victim status in criminal proceedings.

- b. We will also utilize administrative mechanisms for the accountability of the owners of failed banks. As part of our efforts to reduce the ultimate costs of bank failures to the state, we are working on a strategy paper that will propose by end-June 2020 a set of credible measures to improve asset recoveries from former owners of failed banks and their related parties, including through the use of administrative mechanisms. In consultation with IMF staff, we will integrate these improvements into the legislative package enhancing the bank liquidation framework. Based on the draft law that is being developed to replace the Law on Financial Services, the beneficial owners of failed banks will be disqualified from being involved in non-bank financial institutions as an owner or senior manager, and this will be further supported by appropriate declaration requirements. The NBU will take enforcement actions against such owners and managers as identified under this new framework.
- c. We will transparently report on progress our asset recovery efforts. The CMU will continue to publish semi-annual reports summarizing progress in asset recovery and litigation efforts related to the state-owned banks, while the DGF will continue such reporting in relation to liquidated banks, including by publishing on its website the list of all borrowers, managers, and former bank shareholders of resolved banks that are yet to honor their debts related to the failed institutions as ruled by court decisions. Additionally, the new banking law amendments will require banks to disclose their related parties that are in default for more than 180 calendar days.

20. A well-capitalized and funded deposit insurance system is critical for financial stability.

The large amount of depositor payouts following the liquidations of around 100 banks since 2014, together with the low recovery rate of assets, have led to the DGF's insolvency. The Ministry of Finance and the DGF, in consultation with the NBU, IMF and World Bank, will prepare a time-bound plan by end-July 2020 to restore the DGF's solvency by end-2021, while maintaining incentives to maximize recoveries from failed banks. The Financial Stability Council will adopt this plan by end-August 2020.

21. We will ensure that our bank supervision framework is aligned with good practices.

To this end, we will enact amendments to the Banking Law, prepared in coordination with the IMF and World Bank staff: (i) to address the gaps vis-à-vis sound corporate governance practices against the 2015 Basel's Guidelines for Corporate Governance for banks (including the collective suitability of the supervisory board); (ii) to introduce a new capital structure (with appropriate implementation schedule) and capital buffers; (iii) to grant the NBU legal powers to calibrate capital and liquidity

requirements based on the bank's risk profile; and (iv) to strengthen our licensing and shareholder requirements (a **structural benchmark** for end-November 2020).

22. We have improved our current early intervention and resolution frameworks in several respects. To be able to effectively address critical threats to the soundness of our financial system in case of adverse court rulings against past resolution decisions and to fully protect the interests of the State and the Ukrainian taxpayers, we [have enacted], in consultation with IMF staff, as a **prior action**, a legislative package that amended the Banking Law, the DGF Law, the Code of Administrative Justice, and other procedural codes, to make the following urgent enhancements:

- a. **Banking law amendments.** These amendments introduce the notion of professional judgement to support the NBU's discretionary assessments, require the NBU's prior approval all supervisory board members before they take their duty, and enhance our early intervention framework, including problem bank designation and entry into resolution by underscoring the NBU's flexibility to move a problem bank to resolution within the 120-days period and by improving resolution triggers based on capital and liquidity grounds.
- b. **Judicial review of resolution decisions.** The reversal of bank resolution decisions in a series of cases instigated significant legal uncertainties, potentially undermining financial stability and public finances. To balance financial stability concerns with the protection of individual rights in line with good practices, the above law reform amendments ensure that: (i) as with the NBU and the DGF, the CMU's and Ministry of Finance's involvement in systemic bank resolution is protected against injunctive orders and that NBU and DGF officials can also perform their duties without interference by such orders; (ii) courts defer to the technical expertise and discretion of the NBU, DGF, CMU and Ministry of Finance on bank resolution matters; and (iii) given the potential impact of any reversals on financial stability and the interests of depositors, judicial actions cannot result in a reversal of bank resolution measures (including provisional administration and liquidation), but redress is provided only by granting monetary compensation for proven damages (in case of unlawful resolution or liquidation initiation, damages will be determined by an internationally reputable audit company appointed by court and that meets predefined criteria based on the value of shares as of the resolution date, with no share value considered to exist if a bank's net worth was negative in view of all available information, including post-resolution information, and after excluding any public financial support extended to the bank and by deducting any shareholder recoveries during resolution/liquidation). For accountability and transparency purposes, these amendments require that bank resolution decisions are fully substantiated, while the NBU will continue to strengthen its decision-making process;
- c. **Resolution tools.** We have facilitated the effective resolution of a bank through State involvement. Among others, these changes critically incorporated flexibilities to the timelines of resolution tools where the State is involved, including the establishment of a bridge bank before resolution and for a longer period, while benefiting a grace period (3 months) for compliance with prudential ratios. These amendments further provide that the suspension of payments is discretionary if the State is involved in resolution, clarify the specifics of the sale

of shares to the State (including when the State has a partial stake in the bank), define the mechanism for the determination of assets and liabilities to be transferred (including a list of non-transferable liabilities, such as claims of related parties), while facilitating the acquisition of assets and liabilities in bulk with the signing of relevant contracts by an assuming bank or the bridge bank, also as part of the liquidation process, and with the possibility to subsequently rectify errors in account balances.

23. We have further strengthened our crisis management arrangements. We have prepared in consultation with IMF staff, under the upgraded early intervention and resolution framework, a credible and robust contingency plan to mitigate and effectively address potential risks posed to financial stability and public finances by adverse court rulings against past resolution decisions. We have ensured that this plan, that has been adopted by the Financial Stability Council (a *prior action*), is: (a) legally sound; (b) operationally feasible; (c) safeguards financial stability; (iv) minimizes fiscal costs; and (v) minimizes moral hazard risks. The Financial Stability Council will continue to review the level of preparedness of all stakeholders at its regular meetings and will update the plan as needed upon material developments.

24. We are fully committed to strengthening the legal and regulatory framework for non-bank financial markets. As a major step, we have enacted the legislation (split law) that transferred the supervisory responsibility for non-bank financial intermediaries to the NBU. To complement this, we will adopt, by end-October 2020, the draft law (formerly #6303) that enhances the independence and institutional capacity, the cross-border and domestic cooperation mandate, and the enforcement powers of the National Securities and Stock Market Commission to ensure that it meets IOSCO standards. Finally, by end-June 2020, we will adopt the law simplifying investments and introducing financial instruments (#2284). We will closely coordinate with the staff of the IMF and the World Bank to further align these laws with good practices, where needed. We will expand the coverage of the centralized credit registry to the non-bank credit institutions and lower the threshold for submitting information both for banks and non-banks.

D. Structural Policies

Anticorruption and rule of law

25. We are committed to advancing good governance efforts and combatting high-level corruption. We will ensure that the country's new anticorruption institutions—the National Anticorruption Bureau of Ukraine (NABU), the Special Anticorruption Prosecutor's Office (SAPO), and the High Anti-Corruption Court (HACC)—maintain their independence and integrity (including by providing them with adequate resources), to be able to effectively and credibly investigate, prosecute and adjudicate high-level corruption cases. To further support our anti-corruption efforts, we will strengthen and implement the asset declaration and AML/CFT frameworks, and prevent any backtracking from recent gains in the anti-corruption regime:

- a. **Illicit Enrichment.** The criminalization of illicit enrichment is an important tool in the anti-corruption framework and part of the authorities' commitments in the previous IMF-supported program, in line with the UN Convention against Corruption. To address the legal issues raised by the February 2019 decision of the Constitutional Court, we have enacted as **a prior action** a law to re-criminalize illicit enrichment. We will monitor the law's implementation, especially as regards to the link to the income of the public official's asset declaration, criminal prosecution against assets above the designated threshold amount, and acquisition of assets by or through third-parties.
- b. **Anticorruption court.** The HACC, as established under Law No. 2018/2447-VIII, formally began its operations in September 2019. Law No. 2019/100-IX was also passed, which streamlines the jurisdiction of the HACC with respect to corruption cases investigated by NABU and SAPO prior to the court's establishment. Nevertheless, a permanent facility for the HACC has been delayed. We will continue to ensure the full operationalization of the HACC, by providing adequate financial resources for its activities (including staffing and IT requirements and maintaining competitive staff remuneration) and ensuring a permanent and dedicated and adequate suitable facility for the HACC. By end-August 2020, the HACC will have been provided ownership of permanent offices (first instance and appellate levels) that are appropriate for its needs, and security services and protocols for its personnel and buildings. The HACC will publish reports on its performance with respect to the number and types of corruption cases, decisions on convictions or acquittals, and penalties imposed (in line with the template detailed in the TMU).
- c. **NABU Operations.** We will uphold NABU's institutional and operational independence, including by upholding procedures for appointment of its head and maintaining the limited and serious grounds for dismissal of its head, in line with Law No. 2014/1698-VII. We will also maintain NABU's exclusive authority to investigate acts of corruption involving significant amounts or committed by high-level officials. We will strengthen the investigative powers of NABU to use a wide range of investigative techniques, including undercover operations, intercepting communications, accessing computer systems and controlled delivery, without having to rely on other agencies' infrastructure, in line with international AML/CFT standards. In this regard, we amended legislation (Law No. 2019/187-IX) to allow the NABU to independently intercept communications. We will issue all necessary implementing regulations by end-July 2020 and provide adequate resources and equipment to enable NABU to effectively and independently implement interception of communications for landlines by end-September 2020. In addition, we will continue to

maintain adequate financial and human resources for NABU and ensure that staff remuneration remains competitive at the levels provided for in Law No. 2014/1698-VII, as amended. We will ensure the conduct of an external audit of the NABU in accordance with the requirements set out in the NABU Law (Law No. 2014/1698-VII), particularly that the audit will be conducted by a three-member panel of reputable and respected experts with considerable international experience in anti-corruption law enforcement and will be adequately resourced to efficiently, independently and timely complete the audit of NABU. The audit report will include clear and prioritized recommendations on the effectiveness of NABU and its operational and institutional independence, in line with international best practices. We will ensure that the proposed financial investigative body for economic crimes will not have overlapping criminal jurisdiction with NABU and that NABU will have primary jurisdiction over criminal cases of corruption. To monitor its activities, NABU and SAPO will publish in their respective websites quarterly statistics on corruption cases being investigated and prosecuted as well as pending cases before the HACC (in line with the template detailed in the TMU).

- d. **SAPO.** We will ensure the autonomy of SAPO. In this regard, we will review the legal framework to improve the procedures for selection of SAPO officials, strengthen its capacity to regulate its organizational activities similar to the regional prosecutorial offices, and assess its performance through an external audit of reputable and respectable experts with international experience in anti-corruption law enforcement
- e. **E-declaration.** Ensuring that politically exposed persons (PEPs) remain subject to comprehensive and published asset declaration requirements remains a priority, as this is critical to effectively address illicit enrichment and prevent the laundering of the proceeds of corruption. In this regard, amendments to the law on the National Agency for the Prevention of Corruption (NAPC) have been approved that ensure that NABU has direct, unconditional, full and secure electronic access to the NAPC's database of asset declarations of all persons under NABU's investigative jurisdiction (Law No. 2019/140-IX). We have issued and registered the implementing regulations through the Ministry of Justice and will put in place mechanisms to facilitate NABU's automatic and unrestricted electronic access to the NAPC database of asset declarations by end-June 2020. We have also strengthened the governance design and framework of the NAPC to enhance its effectiveness in assessing asset declarations and focus its verification efforts towards PEPs.
- f. **AML implementation.** We remain committed to strengthening and mobilizing the AML/CFT framework to support efforts to tackle high-level corruption. In this respect, we have

enacted amendments to the AML legal framework (a **prior action**), including to ensure: (i) the implementation of a three-tier reporting system (suspicious transaction reports as defined by the FATF, threshold-based reporting of cash transactions and international funds transfers, and mandatory reporting of transactions related to high-risk jurisdictions and PEPs); (ii) that the definition of the persons related to PEPs is consistent with the risk-based approach encouraged by the FATF standard; (iii) that proportionate and dissuasive sanctions can be implemented by the NBU and other supervisory authorities in case of breaches of compliance with the AML framework, (iv) that information on beneficial owners of companies in the Unified State Register of Legal Entities, Entrepreneurs, and Public Associations is up-to-date, accurate and publicly accessible; and (v) that a conviction for a predicate offense is not necessary for the investigation or prosecution of money laundering. By end-December 2020, we will improve the beneficial ownership information contained in the Unified State Register of Legal Entities, Entrepreneurs and Public Associations with mechanisms to sanction legal entities for non-compliance, ensure open and public access to its information, and require that financial institutions report any discrepancies. To monitor its contribution to anti-corruption efforts, the State Financial Monitoring Service of Ukraine (the country's financial intelligence unit) will continue publishing quarterly statistics on the information it disseminates to NABU (in line with the template detailed in paragraph [...] of the TMU). The NBU will continue to conduct at least four quarterly inspections of banks at higher risk of laundering of the proceeds of corruption, focused on regulatory requirements related to customer due diligence and PEPs, including with regard to requirements to identify PEPs, to verify their source of wealth and beneficial ownership information.

26. We will strengthen the rule of law, by ensuring the independence, integrity and accountability of the judiciary. We will ensure that the judicial selection processes and disciplinary mechanisms (including for the Supreme Court) are managed and implemented by persons with high competence, trustworthiness and integrity. We will strengthen the administrative procedures to give sufficiently superior level of judicial consideration to cases challenging the decisions of national state agencies and provide proper safeguards against undue influence on decision-making. In this regard, while ensuring consistency with European judicial standards and Venice Commission opinions, we will:

- a. Amend the Law on the High Council of Justice (HCJ) to enhance the selection process ensuring that its members have impeccable reputation and integrity (an end-October 2020 **structural benchmark**). Through an amendment of the HCJ Law (Law No. 2016/1798-VIII), and consistent with the March 2020 decision of the Constitutional Court, an independent

commission will be established to pre-screen potential candidates to the HCJ and assess their integrity. This commission will perform a similar one-off screening of existing HCJ members. At least half of the commission's members will be respected experts with recognized ethical standards and judicial experience, including with relevant experience in other countries. The commission will give said experts a crucial role and decisive vote. In addition, the amendment will outline the procedures and criteria for the pre-selection process for the HCJ candidates, including a call by the commission for applications. The commission will then nominate at least two persons for each vacancy, which will be forwarded to the respective appointing authorities as designated by the Constitution for final selection and approval.¹ In case of negative assessment by the commission of an existing HCJ member, the commission will send and publish a recommendation for dismissal to the respective appointing authority.

- b. Amend the HCJ's organic law (Law No. 2016/1798-VIII) by end-November 2020 to create a permanent inspectorate unit in the HCJ. This unit will be responsible for investigating disciplinary cases against judges and submitting recommendations to the HCJ for disciplinary actions and sanctions against judges. We will ensure that the unit will be composed of permanent staff to ensure consistency in investigative practice and continuity and evenhandedness in the treatment of judicial disciplinary cases.
- c. Amend the procedural codes to transfer the judicial review of exemplary administrative cases against national state agencies to the Supreme Court, as a court of first instance, and to the Grand Chamber of the Supreme Court, as an appellate court. In further consultation with stakeholders and agreement with IMF staff, the criteria for determining exemplary administrative cases to be transferred to the Supreme Court will be finalized by end-August 2020. The criteria will include such factors such as cases of national importance, cases above a pre-determined threshold amount, or having significant impact or damage to the country, and will cover the decisions, acts or omissions of specific national state agencies (such as Cabinet of Ministers, Ministries, National Bank of Ukraine, Anti-Monopoly Committee, HCJ, NABU, NACP, HACC).

¹ Under Article 131 of the Constitution, the Congress of Judges, the President of Ukraine, the Verkhovna Rada, Congress of Advocates, All-Ukrainian Conference of Prosecutors, and congress of representatives of legal higher educational establishments and scientific institutions elect or appoint the twenty members of the High Council of Justice. The Chief Justice of the Supreme Court is the twenty-first member (ex-officio).

- d. To foster greater efficiencies in courts, Law No. 2020/460-IX has been enacted, which will optimize court procedures by reducing the heavy caseload of courts and rationalize the ability of administrative courts to suspend the decisions of national state agencies.

Energy sector reforms

27. We will continue our efforts to avoid the re-emergence of quasi-fiscal deficits and enhance competition and increase production to achieve energy independence. In doing so, we will continue to provide utility subsidies to low-income and vulnerable households to help defray the impact of gas and heating tariffs on their incomes. Specifically:

- a. **Gas prices.** We have liberalized household gas prices as of January 1, 2020 in line with existing provisions in CMU resolution #867. The wholesale price of gas supplied by Naftogaz under special obligations will correspond to import-parity levels and will be determined for each month as the average of the day-ahead spot prices of natural gas at the TTF hub for the period of the 1st to the 22nd day of the month, plus the cost of transportation and entry into Ukraine. Naftogaz will post the wholesale price within a few business days of the 22nd of each month. We commit to apply this market-based pricing scheme symmetrically, without any ceiling. The Public Service Obligation Order for the supply of gas to households will be terminated on July 1, 2020, after which prices will continue to be fully market-determined. We will ensure that wholesale prices are determined on a transparent and efficient market. The Public Service Obligation Order will remain in effect until May 2021 only for the supply of gas to utility companies and tariffs will be based on fully market-determined gas prices; the National Energy and Utilities Regulatory Commission (NEURC) will bring distribution tariffs to full cost recovery.
- b. **Heating tariffs.** We have eliminated the cap on household heating tariffs by revoking CMU resolution #560 of June 26, 2019 (a **prior action**). We will ensure that, by end-August 2020, all heating tariffs under the jurisdiction of both NEURC and local authorities are reviewed and officially enacted to fully reflect gas and non-gas costs (including capex) (part of a **structural benchmark**). By end-June we will legislate an October 1st, 2020 deadline for all new utility service contracts incorporating the revised heating tariffs to be concluded. Starting with the 2020–21 heating season, heating tariffs will be reviewed and set at least once per year before the start of the heating season to ensure that changes in gas and non-gas costs (including capex) are adequately reflected in heating tariffs. To that end, prior to the start of the 2020-21 heating season, we will rescind CMU resolution #1082 of December 24, 2019, which allows for the asymmetric changes in heating bills without the need to address heating tariffs when the price of input gas changes. In order to mitigate the risk of future arrears we will develop in consultation with the World Bank mechanisms to provide buffers for district heating companies to deal with the volatility in the wholesale gas price.
- c. **Supplier of last resort.** In order to ensure the security of gas supply for households, we will set up a temporary supplier of last resort (SOLR) mechanism. We will select a SOLR through

a competitive tender by end- June 2020. We will ensure that the SOLR has full access to the consumer database (see the joint data hub for gas household consumers below);

- d. **Enhancing competition on the retail market.** We will ensure that the procedure for supplier switching for household consumers is simplified in such a way that: (i) it poses a minimum administrative burden on the household consumer; (ii) it can be carried out through the new supplier who would act as a principal point of contact on behalf of the household consumer; and (iii) the start of the supply by new supplier is not hampered by the existence of a disagreement between the household consumer and the previous supplier, including by any claims of payments outstanding (part of a **structural benchmark** for end-August 2020). In addition, household consumers must have the right to authorize sharing their historic consumption data, and distribution system operators will be required to provide access to their historic consumption data to any supplier of the household consumer's choosing. Such provision of data must be done free of charge. For that matter, we will launch a joint data hub for gas household consumers;
- e. **Debt restructuring and collection of payments.** We will address the issue of indebtedness and payment discipline of households, district heating companies and oblgazs to secure the continuity of gas nominations and to help the development of a competitive market. We will develop adequate instruments for district heating companies to enforce collection of payments from households (including via higher fines and simplified legal enforcement);
- f. **Gas transit.** We have established an independent and commercially oriented gas transmission system operator that is certified by the energy regulator (NEURC), following the review and confirmation by the European Energy Community that it is in compliance with relevant European legislation;
- g. **Regulation.** We will adopt legislation to bring the powers and responsibilities of the energy regulator (NEURC) in line with the EU Third Energy Package and Energy Community Treaty and the 2016 NEURC law by end-March 2021. We shall also amend and enforce gas market secondary legislation in line with the European gas market *acquis*;
- h. **Production.** To increase gas production and help ensure energy independence, we will simplify and accelerate procedures for obtaining permits for the exploration and development of gas fields, while ensuring transparency, including by holding open permit auctions (through ProZorro.Sale) and production sharing agreement tenders. We will also promote investment in existing fields to increase extraction, while ensuring compliance with environmental standards.

Land reform

28. We will establish a market for agricultural land by lifting the moratorium on land sales and introducing a financial support mechanism for small farmers. Specifically:

- a. **Land property rights.** We have enacted the law “On Agricultural Land Turnover” developed with the assistance of the World Bank, but with amendments, to allow Ukrainian individuals to purchase and sell land up to 100 hectares effective July 1, 2021, and legal entities owned by Ukrainians up to 10,000 hectares starting in 2024. We will explore opportunities to bring forward greater participation and competition in the market.
- b. **Safeguards.** We have enacted legislation that mandates: (i) automating the exchange of information between the registry of property rights and the land cadaster, and digitization and transfer to the registry of property rights of all paper records (anti-raider legislation (#0858); and (ii) ensuring free and open access to cadaster data and the inter-operability of the land cadaster and the registry of property rights (#2370). By end-June 2020, we will also enact legislation that (i) establishes a partial credit guarantee fund to ensure financial support to small farmers through provision of portfolio credit guarantees; (ii) streamlines land transfer procedures and decentralizes land management (#2194), transferring state land to communal ownership and shifting land use control functions from the cadaster to appropriate bodies; and (iii) establishes a transparent process for electronic land auctions and mandates the sale of state and communal land on such auctions (#2195).
- c. **Implementation and monitoring.** To ensure legal provisions are implemented and to prevent tax evasion, we will, by January 1, 2021, establish a public monitoring system based on linking information from cadaster, registry, and fiscal service at parcel level. To prevent circumvention of AML/CFT rules we will implement a mechanism to identify the ultimate beneficial owners of legal entities that own land. We will also link the company registry with the registry of property rights and implement sufficient safeguards to ensure that the beneficial ownership data in the company registry is accurate and up to date.

Privatization, state-owned enterprise reform, and markets

29. We remain committed to our SOE-reform strategy, that focuses on significantly downsizing the state-owned enterprise sector. Specifically:

- a. **Privatization.** We have appointed new management at the State Property Fund (SPF), while parliament adopted legislation to reduce the list of companies banned from privatization, leaving only companies of strategic importance or essential for national security on the list. As of end-March 2020, we have transferred 530 companies from line ministries to the SPF. The SPF will aim to launch tenders for the sale of at least 2 large SOEs by end-December 2020, market conditions permitting, and at least 3 more by end-June 2021, including companies from the following list: the Odesa Portside Plant, United Ore and Mining Company, CentreEnergo, Elektrovazhmash, Krasnolymanska mine, and the President Hotel. We will continue with the sale of small companies and assets and leasing of state property through open, competitive and transparent two-tier electronic auctions (ProZorro.Sale). We will amend the privatization law by end-November 2020 to extend the period during which companies can be sold under UK law by at least three years and to enhance the SPF's capacity and streamline its procedures. We have adopted legislation on the leasing of state

property, as well as on concessions to allow additional ways to attract private investment in the management of public assets, including in seaports and airports;

- b. **SOE governance.** We will ensure that SOEs—including state-owned banks—will continue to operate at arm’s length of the government, by safeguarding progress made in strengthening corporate governance, including by maintaining majority-independent supervisory boards. We will further strengthen SOE corporate governance including by: (i) revising the corporate governance framework for SOEs, with the assistance of the OECD and EBRD, to bring it in line with OECD Guidelines on Corporate Governance of State-Owned Enterprises; (ii) adopting the draft SOE corporate governance law to broaden the powers of supervisory boards to appoint CEOs and approve financial plans; (iii) adopting an overarching state ownership policy; and (iv) adopting a new corporate charter for Naftogaz (**structural benchmark**; by end-September, 2020), in line with the OECD’s recommendations on corporate governance, and applicable legislation, including the current law “On Joint Stock Companies”.

30. We will strengthen the Anti-Monopoly Committee of Ukraine (AMCU) in line with international best practices. We will adopt legislation to ensure: (i) its financial and operational independence; (ii) that the appointment and the dismissal of the AMCU’s chairperson and its commissioners are transparent, competitive and insulated from political interference; (iii) strengthens the powers of AMCU to conduct physical searches and confiscate documents and to obtain information from, and share information with other law enforcement agencies and other government bodies; and (iv) that the decisions of AMCU will gain the status of enforcement documents, therefore ensuring that there is no need for a court process to enforce decisions.

Table 1. Ukraine: Quantitative Criteria and Indicative Targets 1/

(End of period; millions of Ukrainian hryvnias, unless otherwise indicated)

	2019	2020		2020	2021	2021
	December	June	September	December	March	June
	Act.	PC	PC	PC	IT	IT
I. Quantitative performance criteria						
Ceiling on the cash deficit of the general government (- implies a surplus) 2/	80,812	180,000	217,000	302,150	45,000	90,000
Ceiling on the cash deficit of the general government and Naftogaz (- implies a surplus) 2/	80,812	180,000	217,000	302,150	45,000	90,000
Floor on net international reserves (in millions of U.S. dollars) 3/	15,785	12,268	9,137	7,567	9,618	10,296
Ceiling on publicly guaranteed debt 2/	4,900	40'000	40'000	40'000	20,000	20,000
II. Continuous performance criterion						
Ceiling on accumulation of new external debt payments arrears by the general government 3/	0	0	0	0	0	0
III. Monetary Policy Consultation Clause (MPCC)						
Inflation target 4/	4.1	5.0	5.0	5.0	5.0	5.0
IV. Indicative Targets						
Ceiling on net domestic assets of the NBU 3/	103,604	225,670	287,818	319,300	278,166	269,552
Ceiling on stock of VAT refund and CIT prepayment arrears 6/	0	0	0	0	0	0
Ceiling on primary expenditure of the state budget and social funds 2/ 7/	1,229,130	n.a.	n.a.	1,437,000	n.a.	n.a.
V. Memorandum Items						
Naftogaz deficit (- implies a surplus) 2/	0	0	0	0	0	0
External project financing 2/	15,900	14,300	18,900	22,700	6,000	12,000
NBU Profit transfers to the government	64,900	n.a.	n.a.	42,710	n.a.	n.a.
Budget support grants	348.1	812.0	1135.0	2,217	804.0	804.0
Government bonds issued for banks recapitalization and DGF financing 2/	0	20,000	20,000	20,000	20,000	20,000
Programmed market issuance, placements and disbursements of international assistance except IMF (millions of U.S. dollars) 3/ 5/	n.a.	2,952	3,510	4,510	6,010	6,568
Use of swaps with other central banks (millions of U.S. dollars) 3/ 5/	n.a.	0	0	0	0	0
Debt service on eurobonds or placements (millions of U.S. dollars) 3/ 5/	n.a.	1,737	3,676	3,758	4,343	4,502
Net issuance of central government domestic FX debt (millions of U.S. dollars) 3/ 5/	n.a.	-385	-994	-1,180	-1,280	-1,449
Use of confiscated assets for FX payments or transfer to NBU gross international reserves (millions of U.S. Dollars) 3/ 5/	n.a.	0	0	0	0	0
Program accounting exchange rate, hryvnia per U.S. dollar	23.6862	23.6862	23.6862	23.6862	23.6862	23.6862

Sources: Ukrainian authorities; and IMF staff estimates and projections.

1/ Definitions and adjustors are specified in the Technical Memorandum of Understanding (TMU).

2/ Targets and projections for 2020 are cumulative flows from January 1, 2020. Targets and projections for 2021 are cumulative flows from January 1, 2021.

3/ Calculated using program accounting exchange rates of 12/28/2019, specified in TMU of 2020 SBA.

4/ End of period, year-on-year headline inflation.

Outer consultation bands, triggering consultation with the Board, will be +/- 3pp for 2020 and 2021.

Inner consultation bands, triggering consultation with staff, will be +/- 1pp.

5/ Projections are cumulative from January 1, 2020.

6/ CIT prepayment arrears are measured as cumulative changes from January 1, 2020.

7/ Primary spending of the State budget plus the consolidated spending of pension and social funds.

Table 2. Ukraine: Prior Actions and Structural Benchmarks

Prior actions	Status	
1. Amend the customs and tax codes, and other laws as needed, to eliminate the regional tax and customs offices as independent legal entities (¶18b).	Met	
2. Enact a legislative package that amended the Banking Law, the DGF Law, the Code of Administrative Justice, and other procedural codes to improve the early intervention and bank resolution frameworks as defined in ¶22.	Met	
3. Adoption by the FSC of a contingency plan to mitigate potential risks posed to financial stability and public finances by adverse court rulings against past resolution decisions that is: (a) legally sound; (b) operationally feasible; (c) safeguards financial stability; (iv) minimizes fiscal costs; and (v) minimizes moral hazard risks (¶23).	Met	
4. Enact legislation to re-criminalize illicit enrichment consistent with international standards and Ukraine's Constitution (¶25a).	Met	
5. Adopt amendments to the AML law consistent with FATF standards and as defined in ¶25f.	Met	
6. Eliminate the cap on household heating tariffs (¶27b)	Met	
Structural Benchmarks	Status	Completion date
1. The state-owned banks' NPL reduction plans to be formally endorsed by the shareholder and approved by the Financial Stability Council (FSC) and the NBU (¶18).		End-June 2020
2. Ensure that all heating tariffs under the jurisdiction of both NEURC and local authorities are reviewed and officially enacted to fully reflect gas and non-gas costs (including capex), , and adopt a simplified procedure for households to switch gas supplier, in line with ¶27 b and d.		End-August, 2020

Table 2. Ukraine: Prior Actions and Structural Benchmarks (concluded)

3. Develop new organizational structures and frameworks for the STS and SCS for the delegation of authorities and accountabilities in both organizations as single legal entities (¶18b).	End-September 2020
4. Enact amendments to the Banking Law, prepared in coordination with the IMF and World Bank staff: (i) to address the gaps vis-à-vis sound corporate governance practices against the 2015 Basel's Guidelines for Corporate Governance for banks (including the collective suitability of the supervisory board); (ii) to introduce a new capital structure (with appropriate implementation schedule) and capital buffers, (iii) to grant the NBU legal powers to calibrate capital and liquidity requirements based on the bank's risk profile: and (iv) to strengthen the licensing and shareholder requirements (¶121)	End-November 2020
5. Enact amendments to the DGF and other laws to improve the bank liquidation mechanism, and the recovery of assets (¶19a).	End-October 2020
6. Enact amendments to the Law on the High Council of Justice (HCJ) to enhance its selection process ensuring that its members have impeccable reputation and integrity, as defined in ¶26a.	End-October 2020
7. Strengthen corporate governance in SOEs, including by adopting a new corporate charter for Naftogaz, to bring it in line with the OECD's recommendations for corporate governance and other applicable legislation, including the law "On Joint Stock Companies (¶29b).	End-September 2020
8. The STS and SCS to operate nationally as two single legal entities both comprising of functionally organized headquarters and field offices and the regional and other legal entities of the STS, SCS and SFS have ceased to exist (¶18b).	January 1, 2021
9. Complete a compliance audit by the State Audit Service of Ukraine, in consultation with external/third party auditors, of COVID-related spending, as defined in ¶2e.	End-March, 2021