

Ukraine: Letter of Intent

Kyiv, March 2, 2017

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Ms. Lagarde:

- 1.** We reaffirm our commitment to the policies and objectives of the economic program supported by an IMF arrangement under the Extended Fund Facility (EFF). In the attached supplement to the Memoranda of Economic and Financial Policies (MEFP) from February 27 and July 21, 2015, and September 1, 2016, we outline further policy steps toward meeting these objectives.
- 2.** We have successfully moved the economy out of the deep recession. The economy is now recovering, inflation has declined to close to single digits, official reserves have more than doubled, and the financial system is getting stronger. This reflects our steadfast efforts to implement the policies and reforms under our EFF-supported program. Nonetheless, the economy continues to face significant challenges, including low growth that does not benefit all, a still high level of public debt, and a weak business climate, including from persistent corruption and an inefficient and large state sector. Remaining weaknesses in the financial sector still prevent it from playing its role in supporting growth. The challenge ahead is to continue to maintain fiscal and external stability, reduce financial vulnerabilities, and most importantly move ahead with the long-delayed structural transformation of the economy to achieve durable, strong and inclusive growth to catch up with our regional peers.
- 3.** Our actions ensured that we met all continuous and end-December 2016 quantitative performance criteria (PCs) and indicative targets (ITs), except for the IT on VAT refund arrears (Table 1). We, however, met only 3 out of 11 structural benchmarks set for the period from September through December 2016 (Table 2), as our focus has been on key measures to ensure fiscal sustainability and financial stability.
- 4.** Most notably, since the completion of the second review, our efforts have been directed at the following (all prior actions for the completion of this review (see also Table 2)):
 - *Fiscal policy.* Parliament has adopted a 2017 budget in line with the program deficit target of 3.1 percent of GDP. To ensure that the deficit target is achieved, we have taken a number of steps, including adopting legislation to limit fiscal risks from the increase in the minimum wage; putting in place an automatic adjustment mechanism for gas and heating tariffs to ensure that tariffs remain at market levels; and adjusting the parameters of the utility-related social assistance programs to ensure their better targeting and efficiency.

- *Financial stability.* Out of the 39 largest banks, most have strengthened their capital position as required under our bank recapitalization program. We have resolved those that were unable to meet minimum capital requirements, including by nationalizing the largest and systemic privately owned bank.
- *Fighting corruption.* For the first time in Ukraine's history, we have published the asset declarations of high-level officials, sending an important signal about our determination to improve transparency. High-level officials that failed to report have been referred to the National Anti-Corruption Bureau of Ukraine (NABU).

5. Against this background, we request to reset—and in a few instances also modify—the remaining eight structural benchmarks as outlined in the attached MEFP and propose a number of new benchmarks to help maintain the reform momentum (see Table 2). Notably, we request that the benchmarks on pension reform and land reform be reset to end-April and end-May 2017, respectively, to provide more time to build social consensus for these critical reforms.

6. On the basis of steps that we have already taken and our commitments for the period ahead, we request completion of the third review, and a disbursement in the amount of SDR 734.05 million based on the end-December 2016 performance criteria. Given the delay in completing this review, we request the fourth review under the arrangement to be based on the end-March 2017 performance criteria, and that the remaining amounts be allocated over the next seven purchases, as set out in Table 3. Furthermore, we also request the completion of the financing assurances review.

7. 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 be appropriate for this purpose. We will consult in advance with the IMF on the adoption of these measures or on any revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such consultation. 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, and the accompanying Executive Board documents immediately upon completion of the review by the IMF's Executive Board.

Yours sincerely,

Petro Poroshenko
President

Volodymyr Groysman
Prime Minister

Oleksandr Danylyuk
Minister of Finance

Valeria Gontareva
Governor, National Bank of Ukraine

Attachment I. Ukraine: Memorandum of Economic and Financial Policies

1. Our policies remain focused on reducing vulnerabilities, accelerating growth and creating private sector jobs, while strengthening macroeconomic stability. We are committed to preserving the achievements to date and to continue implementing in full the measures agreed since the start of the program. Our policies are centered on: (i) maintaining a cautious monetary policy geared toward further reducing inflation and rebuilding reserves, while repairing viable banks and reviving bank lending; (ii) continuing fiscal consolidation to ensure medium-term debt sustainability, supported by pension reform and making the tax system more efficient and growth friendly, while improving the quality of government spending; and (iii) accelerating structural reforms to reform the large state-owned enterprise (SOE) sector, improve the business environment and tackle corruption, to attract investment and raise the economy's potential.

A. Monetary and Exchange Rate Policies

2. We are fully committed to an institutionally strong and independent National Bank of Ukraine (NBU) that can effectively focus on meeting its objectives of price and financial stability. We will ensure that this framework remains unchanged going forward.

3. Monetary policy will continue to be aimed at reducing inflation to achieve the targets under the NBU's inflation targeting framework. The Monetary Policy Guidelines for 2017 and Medium Term were approved by the NBU Council in December 2016, setting inflation targets of 8, 6 and 5 percent for 2017, 2018 and 2019, respectively. These guidelines also define the main principles of our monetary policy, to which the NBU will firmly adhere, including the priority of achieving price stability, maintaining a flexible exchange rate, maintaining NBU independence, and assuring transparency of NBU activities. Within this framework, the NBU will aim to accumulate international reserves in line with our program with the IMF, while gradually relaxing foreign exchange restrictions (see below). The NBU will continue to strengthen its inflation targeting framework, with technical assistance from the IMF, including by enhancing liquidity forecasting and moving toward more active liquidity management to help develop the interbank market, as well as by further enhancing its communication, accountability framework, and macroeconomic modeling. Meeting the inflation targets will help improve policy credibility, lengthen investment horizons, decrease dollarization, and strengthen monetary transmission.

4. The monetary policy stance will remain appropriately tight to achieve these objectives. Given the still elevated inflation expectations and risks to the outlook, we will ease our monetary policy stance gradually as inflation and risks abate and reserve targets are met, maintaining the key policy rate appropriately positive in real terms. In the event of unexpected shocks that endanger the achievement of our inflation targets, we will use the key policy rate and other tools to bring inflation to our target within a reasonable forecast horizon.

5. Our recently announced foreign exchange intervention strategy reflects our commitment to increasing transparency and deepen liquidity in the foreign exchange market. Our strategy remains fully consistent with the objectives of continuing to strengthen our reserve position within a framework where the exchange rate is fully driven by fundamentals. In this regard, we aim to develop a liquid foreign exchange market that will be better able to absorb shocks. With technical assistance from the IMF, the NBU will elaborate the institutional and operational reforms needed to further develop the foreign exchange market and increase its resiliency, while remaining foreign exchange restrictions are gradually being removed.

6. We will continue to ease foreign exchange restrictions and administrative controls as conditions allow. We have agreed with the IMF a revised conditions-based roadmap, taking into account the results of previous relaxations, updated impact assessments and additional stages on the road toward the complete removal of the measures. The roadmap prioritizes easing the more distortive current account restrictions and reducing disincentives for foreign direct investment, conditional on meeting our reserve targets, as well as ensuring macro-financial stability and enhanced information collection and enforcement powers. The NBU will monitor the impact of relaxation measures, update assessments as new information becomes available and adjust the easing steps as needed, in order to ensure that the gradual removal of restrictions remains consistent with the conditions specified above.

7. We have continued to strengthen the governance and operational structures of the NBU. We appointed a new audit committee, with strong professional qualifications to improve the oversight of internal controls. The NBU has also reformed its emergency liquidity assistance (ELA) framework, adopting international best practices. The new ELA framework, which will replace stabilization loans, places emphasis on preparatory work (e.g., pre-evaluation of collateral) that will make it possible to respond quickly when needed, while also having terms and conditions to minimize moral hazard and safeguard the NBU balance sheet.

B. Financial Sector Policies

8. We have taken major steps to ensure a well-functioning and sound financial system. Most of the largest 20 banks (group I) in the country, accounting for 88 percent of banking system assets have been making good progress toward meeting regulatory capital norms in line with the agreed recapitalization plans. Those banks in group I that were unable, according to the 2015 NBU diagnostics, to meet a minimum capital adequacy ratio (CAR) of at least 5 percent, as well as banks in the next group of 19 largest banks (group II) that were unable to reach at least zero capital have been resolved (a *prior action* for this review), and of which PrivatBank was nationalized given its systemic importance. With this, as of mid-January 2017, 88 banks, accounting for almost 50 percent of banking system assets at the beginning of 2014, have been resolved as part of our continuous commitment to strengthen and consolidate the financial system. In addition:

- a. In the case of the recently nationalized PrivatBank, we are taking decisive steps to ensure that its nationalization is efficient and transparent and minimizes costs to the State:
- i. We have appointed a new supervisory and management board. The supervisory board is comprised of seven members that meet the criteria stipulated in paragraph 27b and c of the Principles of State Banking Sector Strategic Reforms.
 - ii. To address the bank's immediate capital needs—arising from loan losses of UAH 155 billion and adjusted by the bail-in of creditors for UAH 29 billion—the Ministry of Finance (MoF) has recapitalized the bank through government bonds in the amount of UAH 117 billion, issued at market-based rates. In case of liquidity needs, the NBU stands ready to purchase a portion of these instruments or provide refinancing loans secured by the above-mentioned recapitalization bonds, while ensuring consistency with the NBU's monetary program. The currently outstanding NBU liquidity facilities will not be restructured in a way that the effectiveness of the former bank owners' personal guarantees associated with such facilities is undermined.
 - iii. To remove uncertainty and strengthen depositors' confidence during the nationalization phase, we have passed legislation to temporarily protect PrivatBank's household deposits in full. In the context of the Principles of State Banking Sector Strategic Reforms, we intend to gradually remove the government guarantee on deposits held in state-owned banks (SOBs).
 - iv. The bank's new supervisory board has already: (a) selected an internationally recognized audit firm to perform a due diligence of the bank's balance sheet at its intervention date, as required by the Deposit Guarantee Fund (DGF) law, to define the nationalized bank's capital needs according to fair value practices; and (b) approved the establishment of a specialized unit inside the bank to manage and restructure loans and financial leasing agreements of about UAH 155 billion identified by the NBU to be related to the former bank owners on the basis of the current legal and regulatory framework, as well as other impaired loans. Before end-March 2017, the bank's General Meeting of Shareholders will approve the terms of reference—developed in consultation with IMF staff—for, and launch the process for hiring of, an internationally recognized firm (IRF) with the appropriate expertise that, on behalf of the bank, will negotiate the restructuring and collection terms of the loans above mentioned, as well as of other impaired loans, which requires the use of similar approach, on the basis of international best practices, including as a minimum borrowers' and lessees' reliable and credible supporting information on ultimate beneficiary owners, financials, main activities, and proper collateral valuation. Furthermore, we will ensure that the bank's supervisory board by end-April 2017 selects the IRF on the basis of a transparent process, and selects a reputable international audit firm to conduct for the next two years a semi-annual detailed independent loan review (in accordance with the legal and NBU regulatory framework), with the aim of properly

monitoring asset value recovery (a new **structural benchmark**). These interim reports, prepared by the audit firm will be completed by end-September 2017, end-March 2018, end-September 2018, and end-March 2019, respectively.

- v. The supervisory board is expected to approve by mid-May 2017 the IRF's strategy to restructure the above-mentioned loans through end-June 2017, which will reflect best practices—a brief summary of this strategy and bi-monthly implementation progress reports will be made public in a timely manner, and consistent with applicable banking secrecy and data protection requirement, at the bank's website.
 - vi. By end-May 2017, in consultation with IMF staff, on the basis of the above mentioned due diligence and the bank's business plan (prepared by its newly appointed supervisory and management board)—which is to include restructuring and strategic measures (including as regards to lending activities through end-2018)—we will decide on final steps to complete the bank's restructuring, including the coverage of any additional capital needs assessed at that time. The MoF (through its FPD) and the NBU will require the bank to submit bi-monthly progress reports on the implementation of its business plan to ensure effective official monitoring.
 - vii. By end-June 2017, the IRF, in close coordination with the bank's supervisory board, will seek to complete the restructuring and collateral enhancement or collection of PrivatBank's impaired loans, including those to parties related to its former owners, in line with the principles established in the strategy above, such that the losses associated with these loans that were accounted by the DGF at the time of the bank's intervention are reversed. .
 - viii. We remain fully committed to follow international best practices and the banking law to pursue all legal and commercial means available to recover the loans mentioned above in a timely manner. In this context, by mid-March 2017, the NBU will extend and expand the work of the internationally recognized firms that have been assisting the NBU in this case. This includes expanding the mandate of the internationally recognized firm that had been assisting the NBU in identifying related-party transactions to perform a forensic audit of PrivatBank's operations to identify whether wrongdoing or bad banking practices took place prior to the bank's nationalization, with the aim to complete this audit by mid-September 2017.
- b. To ensure sufficient time for the verification of group II and III banks' recapitalization and unwinding measures, we have slightly revised the timetable for their compliance as shown in the table below.

Calendar of next 100 banks	Completion of		Recapitalization to	
	Diagnostics	Board Approval	Zero Tier 1	CAR of 5 percent
Group II (largest 19)	End-May 2016	End-July 2016	Mid-January 2017	End-April 2017
Group III (next 21)	End-September 2016	End-December 2016	End-March 2017	End-June 2017
Remaining banks	Continuous process to be completed by no later than End-September 2017			

- c. From the banks of groups I and II showing negative operating profitability through 2017, we have requested the submission of restructuring plans (including quarterly targets) by end-April 2017, with measures to be adopted in the next 36 months to reverse such trend and ensure their viability. By end-June 2017, the NBU, in consultation with the IMF and World Bank staff, will review these plans and approve when adequate. Furthermore, banks from group III showing such patterns through 2018 must submit their restructuring plans by end-May 2017 and the NBU shall complete their review by end-July 2017.
- d. In addition, we have started focusing on strengthening all remaining banks in the banking system. The completion of the diagnostics of the remaining banks (accounting for less than 2 percent of the system assets) will be completed by end-September 2017, on the basis of terms of reference already agreed with IMF and World Bank staff. Where applicable, the remaining banks will submit their restructuring plans on a continuous process to be reviewed and approved by the NBU no later than end-December 2017. Furthermore, as envisaged in the current legislation, we will ensure that by mid-July 2017 all banks hold at least a minimum capital of UAH 200 million. Banks that fail to meet this requirement will be resolved.

9. We will ensure that all banks strictly adhere to targets set for the unwinding and limitation of their exposure to related parties. To this end, the Related Party Monitoring Office (RPMO), in addition to overseeing banks' full adherence to their unwinding plans in strict compliance with the terms of reference agreed with IMF staff, by end-March 2017, will complete a work plan for the following 12 months on the basis of a revised set of objectives, modes of coordination with other relevant NBU departments, and monitoring procedures, agreed with a recent IMF TA mission. Furthermore, we remain committed to keep the RMPO as the undisputed center of expertise on related-party issues, as envisaged at its creation.

10. We are working toward establishing a credit registry in NBU. To this end:

- a. By end-March 2017, we will seek parliamentary approval of legislation to authorize the NBU to establish a credit registry with a view to start collecting information from banks by end-September 2017 and by end-December 2018 commence sharing this information with the banking industry (disclosing borrowers' exposures loan by loan, but without indicating what individual institution is the creditor), with the view to enhance its lending practices, according to a minimum threshold defined by the NBU in line with international best practices (including credit risk assessment). Furthermore, considering that nearly 80 banks are under liquidation, the

legislation will also introduce requirements on these institutions to regularly report to the NBU their credit data and allowing the NBU to share such information with private credit risk bureaus.

- b. Within two months of the adoption of the above-mentioned law, the NBU will issue the corresponding regulations and action plan to ensure timely implementation.
- c. By end-April 2017, in consultation with Fund staff, we will define proper procedures to share NBU information on the composition of related economic groups with the industry, to enable banks to effectively enhance the monitoring of their credit concentration limits.

11. We continue enhancing our supervision and regulation of banks. By end-March 2017, with input from the IMF and World Bank staff, the NBU will complete the identification of remaining key policy measures that are required to ensure our compliance with the Basel Core Principles (BCPs) as per our peer group, on which basis we will prepare an action plan through end-2019, to be approved by the NBU Board by end-April 2017. Furthermore, on the basis of its assessment of the banks' pro-forma balance sheet, the NBU will have amended its new regulation on credit risk to make it technically better calibrated with best practices. The potential impact of these changes will be communicated to each individual institution that has additional capital needs arising from the adoption of the new regulations, requiring them to reflect this in the remaining horizon of their recapitalization plans. Additionally, the NBU will:

- a. By end-April 2017, prepare an interim report board on progress made toward adopting risk-based supervision by end-June 2017; and
- b. By end-May 2017, with technical external assistance, benchmark its revised supervisory structure, internal procedures (including coordination between offsite supervision and onsite inspection) and administrative arrangements (including staff count and budgets) against those of peer countries.

12. We will take steps to ensure effective corporate governance in banks. We have completed the initial assessment of our current regulatory and supervisory framework for sound risk governance practices against the 2015 Basel's Guidelines for Corporate Governance for banks. Additionally, we have issued prudential regulations towards enhancing governance at banks, including guidelines on the functioning of internal audit functions. Going forward:

- a. By end-March 2017, the NBU will submit draft legislation to parliament to address legal loopholes arising from the assessment above mentioned. We expect parliament to adopt this legislation by end-June 2017. The NBU will adopt revised or new resolutions reflecting the findings of the assessment for full implementation no later than end-December 2017; and

- b. The NBU, with external support, will: (i) by end-September 2017 approve a regulation on minimum organizational and functioning conditions for an effective risk management system at banks; and (ii) by end-April 2018 complete its assessment of the collective suitability of the board and qualifications of senior management of the 10 largest banks and, where applicable, instruct banks to adopt corrective measures within 90 days. By end-July 2018, a similar assessment for the next 10 largest banks will be completed. The remaining banks will be subject to the same review through end-April 2019 in line with a calendar to be agreed with IMF staff by end-September 2017.

13. We continue implementing our strategy for the public banks. The strategy includes the Principles of State Banking Sector Strategic Reforms to govern the SOBs, approved by the Cabinet of Ministers of Ukraine (CMU) in early February 2016. The MoF, in consultation with IMF staff, will prepare amendments to the strategy in light of the nationalization of PrivatBank, to be approved by the CMU by end-April 2017. Based on this strategy:

- a. The CMU will assume the role of controlling shareholder of the SOBs, supported by the MoF's FPD.
- b. In consultation with IMF staff, in March 2017 we will submit to parliament the draft law on SOBs that facilitates the adoption of the new corporate governance approach and expect this law to be adopted by end-March 2017.
- c. By end-March 2017, with IMF technical assistance, we will complete a new organizational structure of the FPD and an action plan for its strengthening through end-June 2017, for it to be able to effectively support the CMU's function of managing the State's interest in the SOBs.
- d. By end-June 2017, the MoF's Financial Policy Department (FPD), in consultation with IMF staff, will establish Memoranda of Understanding with all SOBs (PrivatBank, Oschadbank, Ukreximbank, Ukrgasbank) in order to *inter alia* define a relationship framework between the MoF and each bank, and safeguard each bank's commercial independence in achieving its objectives.
- e. The supervisory board of each of the SOBs will be selected in line with the Principles of State Banking Sector Strategic Reforms, which *inter alia* requires the candidates to be proposed by a reputable international recruitment firm. However, if the SOBs were to receive private participation, the selection process of the independent members of the SOB's supervisory boards will be made on the basis of the Law on State-Owned Enterprises.
- f. We will refrain from making operational the recently created Export Credit Agency until all related cost and capital needs for the next three years are clearly identified, on the basis of an independent assessment, and included in the government budget.

14. The DGF is working to further enhance its transparency, recovery procedures, and asset disposal procedures. A centralized unit at the DGF is now set to consolidate the management and control of bank assets from the nearly 80 resolved institutions. We fully commit to:

- a. We will submit legislation to parliament that will further enhance the DGF's ability to work with assets in a timely and efficient manner and increase the amount of net cash recoveries on assets, as well as providing legal protection to DGF staff. We expect this law to be adopted by end-March 2017.
- b. The first executive summary of the forensic audits was published and the second will be published by mid-March 2017. By mid-March 2017, the DGF also will launch the selection process for the next three forensic audit exercises.
- c. The disposal of assets through international platforms of distressed assets, aiming to dispose of at least UAH 10 billion worth of assets by end-June 2017.
- d. By end-September 2017, the DGF will publish its review of a selected pool of assets sold in the preceding two years. To this end, by end-March 2017, the DGF will agree with IMF and World Bank staff the terms of reference for its regular examinations of asset sales, including their scope and frequency.

15. We will further strengthen our regime for corporate debt restructuring and protection of creditors' rights. Parliament already adopted amendments to the Law on Enforcement Procedures to speed up the enforcement process. By end-September 2017, parliament is expected to adopt the amendments to the Law On Restoration of Debtor's Solvency or Declaration of its Bankruptcy (draft bill N0. 3132(d)), to facilitate restructuring procedures and increase the efficiency of liquidation (a new deadline for this **structural benchmark**, reset from end-September 2016). Parliament will also adopt by end-September 2017 legislation to strengthen the provisions in the Code of Civil Procedure and the Code on Commercial Procedure and related laws on the automated collection and enforcement of debts (Orders for Payments for domestic transactions and Garnishment of Bank accounts (a new deadline for this **structural benchmark**, reset from end-September 2016). Furthermore, recognizing the need to eliminate tax disincentives to restructuring, by end-June 2017 the MoF, in consultation with the NBU, will submit legislative changes to the tax code to change the definition of "bad debts" to allow for the write-off uncollectable debts without having to initiate or complete a bankruptcy process (e.g., 360 days post default) and to extend the tax incentives available on a temporary basis to out of court restructurings under the Law on Financial Restructuring to debt restructurings subject to the insolvency law. Additionally, regarding the possible restructuring of mortgage loans denominated in foreign currency, in line with our commitment made in earlier MEFPs, we will support only legislative initiatives that are consistent with the existing agreement reached between the NBU and the banking industry.

16. We are committed to establishing a strong regulatory framework for securities markets and non-bank financial institutions, as well as banks. To this effect:

- a. We are reinforcing the powers, independence and institutional capacity of the National Securities and Stock Market Commission (NSSMC), aiming *inter alia* at allowing it to become a signatory to IOSCO's Multilateral Memorandum of Understanding. To achieve this, we will seek parliamentary approval by end-April 2017 of legislation that meets the objectives outlined in points a through j of paragraph 22 of the Memorandum of Economic and Financial Policies dated September 1, 2016.
- b. With the assistance of international donors, the NSSMC is reforming its internal organization and procedures. In particular, a functional structure is being introduced to replace the sectoral one. A further redesign of key processes including governance mechanisms, decision-making procedures, responsibilities, internal controls and operational risk prevention systems will be developed and implemented during the next 18 months. To this end, by end-April, 2017 we will agree with IMF staff an action plan with clear quarterly targets.
- c. Supervisory responsibilities for a variety of financial intermediaries will be reassigned from the National Commission of Financial Services (NCFS) to the NBU and the NSSMC. In particular, the NBU will become responsible for the regulation and supervision of insurance and leasing companies, credit unions, credit bureaus and other non-bank lenders, pawnshops and other financial companies and the NSSMC for private pension funds, issuers of mortgage certificates, funds for construction financing and real estate funds. The relevant legislation was adopted by parliament in first reading in July 2016. We are working to ensure that this legislation is adopted in second reading by end-March 2017 and fully implemented by end-December 2017.
- d. To improve the functioning of financial markets, enhance transparency and the quality of issuer disclosures, and to reduce the scope for corruption and fraud, we will adopt a new Audit Law and a revised Accounting Law based on EU standards. These laws, which have been developed with assistance from the EU and the World Bank, will bring Ukraine's accounting framework broadly in line with the EU Accounting Directive and establish a new oversight structure for the audit profession, while safeguarding the NBU's and NSSMC's ability to set additional standards for auditors of banks and other regulated entities (professional market participants and issuers) in a transparent manner. These laws will be adopted by end-July 2017.

C. Income Policies

17. To reduce extensive labor informality and support vulnerable households, we have increased the minimum wage to UAH 3,200, effective January 1, 2017. While we believe this was a necessary step, we recognize that it also poses risks to our macroeconomic achievements to date, including fiscal sustainability and competitiveness, if this is followed by generalized and significant wage increases in the economy beyond productivity improvements. To limit these risks, parliament adopted legislation to delink the minimum wage from

a range of wage setting and administrative decisions, as described below, to ensure that the impact on the budget deficit will be neutral. We will also refrain from further increasing the minimum wage in 2017, and any increases in 2018 and thereafter will take into consideration the impact on employment, including of the youth, and competitiveness. We will also adjust the minimum subsistence level in 2017 in line with inflation. We expect our comprehensive pension reform efforts (described in paragraph 21a) to open up the necessary fiscal space for paying better pensions to the population over time. Further, we will take the following measures:

- **Fiscal sustainability.** The increase in the minimum wage is expected to increase the wage bill of the general government to 11.3 percent of GDP in 2017, significantly above our previous plans. To ensure that the wage bill declines over time to more sustainable levels, we will accelerate fiscal structural reforms including by implementing health and education reforms to reduce the size of the public sector, comprehensive pension reform, as well as civil service reform, including by delinking the civil service wage grid from the minimum wage and revisiting the new civil service law in consultation with the EU and the IMF (see paragraph 21b).
- **Informality.** To reduce the risks that the minimum wage increase will lead to further dropouts from the formal sector, particularly of the young and low-skilled workers, thus increasing the shadow economy, we will accelerate tax administration reforms, including by tightening the simplified tax regime, abolishing the moratorium on tax audits and labor inspections of small enterprises, increasing penalties for undeclared labor, and enhancing inspections (see paragraphs 19–20).
- **Competitiveness.** To limit the impact of the increase in minimum wages on labor costs that could undermine competitiveness at a time that growth is still weak, we will decouple collective agreements from the minimum wage. In addition, we will accelerate productivity enhancing reforms to reduce the costs of businesses, as specified in paragraphs 27–28.
- **Employment.** Further, we will limit any adverse impact on employment, especially of the youth, by (i) improving the system of apprenticeship through a removal of the restrictions contained in the labor code; (ii) modernizing the system of vocational training to address skill mismatches in the labor force; (iii) removing outdated norms that limit employers' ability to adjust employment to labor conditions; and (iv) limiting the scope of "protected" categories of employment by end-December 2018. More generally, in the period ahead we will proceed with a revision of our labor code to remove existing rigidities and to better adapt it to today's labor market needs by end-December 2017.

D. Fiscal Policies

18. Fiscal policy in 2017 and beyond will be anchored by our medium-term consolidation plan reflected in our IMF-supported program. Parliament adopted a budget for 2017 and supporting legislation consistent with a general government deficit ceiling of 3.1 percent of GDP (a *prior action* for this review). We aim to gradually

reduce the general government budget deficit to 2½ percent of GDP in 2018 and 2¼ percent of GDP in 2019. This will be achieved mainly by reducing current spending, while providing for an increase in capital investment spending to improve public infrastructure. Any revenue over-performance will either be used to clear the stock of corporate income tax prepayments, further increase capital spending, or will be saved. We will also regularly review revenue-sharing and expenditure assignment responsibilities between the central and subnational budgets to avoid accumulation of imbalances at the local government level.

Revenue measures

19. Further tax reform will aim to increase the efficiency and equity of the tax system. We will refrain from any major tax cuts and will not introduce new tax exemptions and amnesty schemes. We will substantially tighten the simplified tax regime from January 1, 2018, which provides a major loophole in our tax net. We will also refrain from introducing preferential tax treatment—other than for local property taxes—for companies operating in industrial zones. To allow us to efficiently implement the harmonization of filing and payment of social security contributions and personal income tax, we will submit legislation to parliament for adoption by end-April 2017. We will legalize amber mining and gambling, which should provide additional revenues to the budget not later than in 2018.

20. We will accelerate revenue administration reform to help de-shadow the economy, broaden the tax base and improve the business climate:

- a. **Transparency and accountability.** We are establishing a strong oversight and accountability framework of the MoF over the State Fiscal Service (SFS). For the first time, the MoF has established Key Performance Indicators (KPI) for the SFS, to monitor its progress in reform implementation. These KPIs will be published on a quarterly basis. In addition, to ensure integrity of the SFS information-technology (IT) operations, by end-June 2017 we will complete an external audit of SFS' IT systems and databases, and establish a strong oversight role of the MoF over SFS IT operations. To this end, by end-March 2017, the MoF will issue a resolution setting standards and goals for both the development and integrity of SFS software, the implementation of which will be monitored as a new KPI. The resolution will allow the MoF to have access to tax data in the SFS Management Information System that will not be identifiable by individual taxpayer, in an online format, as well as to have the ability to monitor and audit changes in taxpayer data. To this end, we will establish adequate audit capacity in the MoF and introduce key technological controls. We will conduct and publish semi-annual surveys of taxpayers to assess their perception of corruption at the SFS, as well as their overall assessment of the quality of SFS services.
- b. **Institutional strengthening of the SFS.** The main objectives are to increase the effectiveness, efficiency and integrity of the SFS and turn it into a service-based revenue collection organization. The full merger of tax and

customs administrations into a single legal entity is expected to be completed by end-March 2017 (a new deadline for this **structural benchmark**, reset from end-December 2016). We will also consolidate regional tax and customs offices into a single office per region by end-March 2017. The MoF and SFS are in the process of agreeing a methodology and process for accelerating the vetting of SFS staff. Following this, a new funding model for the SFS to ensure adequate salaries for the vetted SFS staff will be adopted by end-March 2017. In order to strengthen the SFS' audit and enforcement capacity we have restored its powers to audit small and medium-size taxpayers from January 1, 2017 and we expect parliament to adopt by end-December 2017 legislation that will grant the SFS powers to use indirect methods to ascertain tax and social security contribution obligations. The lifting of the moratorium on audits will allow the SFS to undertake more targeted inspections of companies to identify undeclared employees. We also intend to improve the quality of tax audits and establish a new, analytical risk-management unit responsible for the identification of risk criteria for the detection of non-compliance by mid-March 2017.

- c. **Reform of customs operations.** The cabinet will approve a new comprehensive customs reform strategy by end-March 2017 along with a detailed action plan, which will include the task to reduce the number of inland clearance facilities during 2017 by at least one third. We have established multi-agency mobile groups under the MoF, which have become operational since September 2016, to fight fraud and smuggling outside the border crossing points, while new inter-regional customs offices will operate at border crossing points only. We are also strengthening the SFS' partnership with the State Border Guard and have begun exchanging information in real time. To support our efforts to exchange information with major trading partners, we will approve an action plan on accession to the convention on a common transit procedure and the convention on a Single Administrative Document (SAD), and start implementing the New Computerized Transit System (NCTS) by end-2017. We will develop a control management strategy to complement the risk management strategy. By end-June 2017 the SFS will create a unified customs value reference database and build adequate capacity to ensure a regular update and analysis of prices on international markets and an effective oversight of and support to the valuation field work at the regional offices of the SFS. These efforts will be monitored by the MoF to ensure that this reference database is kept up-to-date and adequately reflects developments in international markets. We will publish by mid-March 2017 both the new Code of Conduct and the Anti-Corruption Program.
- d. **Reduction in compliance burden on taxpayers.** To help achieve a better image of the SFS and encourage voluntary tax compliance, a single-level dispute resolution system will become effective at SFS headquarters from March 1, 2017. We will also introduce record-keeping of outcomes of court decisions after the completion of the administrative appeals procedure. This will help us assess the effectiveness of the appeals system at the SFS. We will increase opportunities for electronic filing of tax returns, aiming that at least 70 percent of taxpayers

will be filing their tax returns electronically by end-December 2017. The SFS will also improve the quality of taxpayer consultations.

- e. **Reform of financial police.** Parliament is expected to adopt legislation to establish by end-April 2017 (a new **structural benchmark**) a new civil service responsible for investigation of financial offences against the State under the MoF to replace the current tax police and to consolidate responsibilities of fighting financial offenses against the State into a single agency, while avoiding duplication of functions. The new financial police will have a much smaller staff, the majority of which will be hired outside the current law-enforcement system and will be better paid and equipped. Responsibilities of the new financial police and the SFS will be clearly delineated and we will ensure that strong cooperation exists between the two agencies. At the same time, we will maintain adequate capacity in the SFS allowing it to fight against tax fraud.

Expenditure measures

21. We will accelerate structural fiscal reforms to improve the structure of public finances and consolidate our fiscal position, while increasing the efficiency and quality of government spending:

- a. **Pension reform.** We recognize that the pension system needs to be reformed. Structural problems in the labor market (low compliance of social security contributions and low participation rates), unfavorable demographics, and outdated pension rules have eroded the sustainability of the pension system. Pension expenditure is very high, even though most individual pensions are relatively low, as the number of pensioners has grown disproportionate to the active labor force. As a result, the deficit of the pension fund has exceeded UAH140 billion in 2016 (about 6 percent of GDP), and is set to widen further without any changes, which puts in danger the viability of the pension system in the future. To put the pension system on a sustainable basis, provide incentives for workers to contribute, and ensure adequate pensions over time, parliament will adopt by end-April 2017 a comprehensive pension reform (a new date for this delayed end-December 2016 **structural benchmark**) that will become effective by January 1, 2018. This reform will have the following features: (i) a new set of retirement options, with a wider range of retirement ages than at present, offering an important degree of choice and dependent on total years of service, and with pension benefits that provide incentives for longer employment and later retirement; (ii) savings of at least 3 percent of GDP over the long term, including by lengthening the effective years of service at retirement; and (iii) an assurance that Ukrainian citizens have pensions that are proportionate to their contributions and adequate in real terms. This general system will apply to all categories of employment, except for a limited number of hazardous occupations. For the latter, a surcharge on social security contributions will be introduced payable by employers that is actuarially fair, which will be accumulated on personified accounts and will be used as bridge financing between the early retirement and the system described above. In addition, we will increase our efforts to expand the base for social security contributions.

- b. **Public administration and remuneration reforms.** To limit the effect from the doubling of the minimum wage in 2017, we have delinked base salaries for civil servants from the minimum wage. We have also suspended the application of the provision in the civil service law that envisaged a gradual increase in the base salary. By end-June 2017, we will undertake a comprehensive review of the overall remuneration system of the public sector taking into consideration the current legal framework and its impact on the wage structure, compression, and the overall wage bill. We will start a medium-term program of public sector downsizing and plan to reduce the size of employment in the budgetary sector (excluding the military) by at least 4 percent by end 2017, and by a further 10 percent by end-2019. In the civil service, we will continue downsizing through further optimization of ministries and other government agencies and introducing more efficient procedures, and also aim to reduce the number of staff by 5 percent by end-2017 and by a further 10 percent by end-2019. We are also building a central civil service information system and will start reporting on the number of civil servants as well as on the number of budgetary sector employees on a semi-annual basis. To monitor progress, we have established an indicative target on employment downsizing.
- c. **Healthcare reform.** We are launching deep and comprehensive healthcare reforms to increase the efficiency of spending and improve outcomes. In the first phase of the reform, we will introduce a new mechanism of financing in primary healthcare based on the principle of "money follows the patient". As a result, from July 1, 2017, primary healthcare facilities will receive budget financing based on the number of individuals registered with a chosen physician in a particular facility or a private practice. This financing will be universal and its size will vary by age. The procurement of healthcare services will be conducted by the single national purchasing agency (the National Health Service), which will be established in the first half of 2017. From 2018 the National Health Service will operate the funding for specialized and hospital care as well as outpatient pharmaceuticals. From early 2017, we will start establishing about 100 regional hospital districts within a defined territory in each oblast, thus eliminating duplication in the provision of healthcare services and building upon complementarities. This will help to significantly reduce large excess capacity in the hospital sector and improve the quality of services. In 2017, we will also introduce an outpatient drugs reimbursement program, gradually expanding the coverage of drugs.
- d. **Social assistance administration reform.** We are determined to strengthen control over the provision of social payments and improve targeting to minimize leakages to non-eligible beneficiaries. To this end, as part of the 2017 budget legislation, we have amended the legislation that will allow the MoF, in the process of verification of social payments, to access the unified database of civil status, the registry of voters, and other relevant databases. Moreover, by end-June 2017, parliament will adopt legislation to establish means-testing for the recipients of all social assistance, based on households' income and assets. Based on this, we will discontinue payments to non-eligible recipients. We will also establish a single centralized database under the MoF of all recipients of social assistance and their benefits (a new **structural benchmark** for end-December 2017).

Institutional reforms

22. We have approved a comprehensive public finance management reform strategy for 2017-21, and have started its implementation. Under the strategy, we will ensure a full-fledged implementation of the Medium-Term Budget Framework and the strategic planning for more effective and efficient resource allocation. In order to strengthen overall fiscal discipline, we plan to develop a fiscal rule by mid-2018. We will also introduce a comprehensive fiscal risk management system and adopt the necessary legislative changes by end-December 2017 to cover and reduce macroeconomic risks, risks related to SOEs and public asset management, public guarantees, local borrowings, public private partnerships, and other risks. To strengthen public investment management, we will implement strategic planning of public investments, create a single 'entry point' for investment proposals, and institutionalize project management by end-December 2017. We will improve the efficiency of internal control and audit functions in central and local authorities during 2017–18.

E. Energy Policies

23. We will continue our efforts to better target social assistance, improve household incentives for energy efficiency and keep spending within budget limits. To this end, we have reduced consumption norms from 5.5 to 5.0 cm per m² for gas for individual heating, from 65 to 51 kwh per m² for electricity used for individual heating, and from 0.0548 to 0.0431 Gcal per m² for centralized heating effective May 1, 2017 (a delayed end-September 2016 **structural benchmark** and a **prior action** for this review). In addition, by end-July 2017, we will: (i) revise other parameters of the household utility subsidies (HUS) system to improve targeting; (ii) introduce an adjustment to the social norm for off-peak heating months; and (iii) apply a capacity-based distribution tariff for gas and heat that would shift some of the costs to the Summer, all effective August 1, 2017 (a new **structural benchmark**), thereby limiting HUS outlays to UAH 47 billion in 2017.

24. We will continue our efforts to transform the gas sector. Specifically:

- a. **To ensure that tariffs remain at full cost recovery**, we have revised the Public Service Obligations (CMU Resolution 758) to introduce an interim mechanism to automatically adjust retail gas and heating tariffs on a semi-annual basis if tariffs deviate from full cost-recovery levels (based on import parity as defined in the TMU) by 10 percent or more (a **prior action** for this review). The interim adjustment mechanism will remain in place until tariffs are fully liberalized. We will also adjust the price of domestic gas (UGV price) semi-annually starting April 1, 2017 to ensure that it remains in line with import prices.
- b. **To facilitate the full liberalization of gas tariffs**, by end-August 2017, we will adopt a CMU Resolution to monetize the benefits of the HUS program at the level of utility companies as of end-September 2017 (a new **structural benchmark**), so that private gas traders can compete with Naftogaz to supply gas. We will also work toward the monetization of utility subsidies at the household level to help improve energy efficiency. Also by

end-September 2017, we will further amend CMU Resolution 758 so that tariffs on gas transportation and distribution are separated from the gas cost as commodity. We will cancel the scheme that allows a 12-month installment plan to pay heating bills for households that do not receive subsidies (CMU resolutions 630 and 357) by May 1, 2017. We will also reintroduce the sunset clause to CMU resolution 217 that earmarks heating company revenues for specific (non-gas) operating costs by April 1, 2017.

F. Governance, Business Climate, and State-owned enterprises

25. We have made progress in advancing our structural reform agenda aimed at addressing corruption, strengthening the business climate and improving governance at SOEs. We will continue with these reforms aimed at transforming our economy in the period ahead.

Anticorruption

26. We are making strides in our fight against high-level corruption, building upon the e-declaration of assets and the AML framework, and the increase in criminal investigations. Looking ahead we will focus our efforts on addressing impediments to the effective implementation of our anticorruption efforts:

- a. **E-declaration.** We have enforced the submission of the 2015 income and asset declaration by high-level officials. The submitted declarations have been made publicly available and the National Agency for Prevention of Corruption (NAPC) has reported cases of officials who did not submit a declaration to the National Anticorruption Bureau of Ukraine (NABU), as required by law 2014/49 (a **prior action** for this review). The number of high level officials that filed the asset declarations was [...] and the number of non-filers reported to NABU was [...]. To monitor progress made in verifying asset declarations of high-level officials, NAPC will publish statistics on a quarterly basis starting on a webpage freely available to the public (in line with the template detailed in paragraph 98 of the TMU). In light of the unexpectedly low level of bank accounts and other assets disclosed abroad, the NBU, and the Financial Intelligence Unit (FIU) will inform their counterparts in key financial centers abroad that the absence of declaration of assets owned or beneficially owned by Politically Exposed Persons (PEPs) or their family members and associates in foreign jurisdictions may constitute a crime under Ukrainian law and a money laundering offence in these jurisdictions. Looking ahead, we will enforce the filing of comprehensive asset declarations by all high-level officials including managers of SOEs, for the calendar year 2016, as defined under Article 46 of law 2014/49, by April 1, 2017. Following this, we will evaluate the effectiveness of the asset declaration requirements to ensure that they remain appropriately focused on high-level officials and will consider amending the categories of officials that will be required to submit asset declarations.
- b. **NABU operations.** Parliament will adopt legislation to strengthen the powers of NABU in line with paragraph 36.a of the September 2016 MEFP by end-May 2017 (a new deadline for this **structural benchmark**, reset from

November 2016). By end-December 2016, NABU had hired 542 staff out of its full complement of 700 staff and opened three regional offices. It started demonstrating its ability to investigate high-level officials, with 8 members of parliament, 39 judges, 23 prosecutors] and 52 SOE managers having been under investigations since the beginning of NABU operations. NABU investigations, under the supervision of the special anti-corruption prosecutor, led to more than 40 cases having been sent to court, and to the lifting of the immunity of a member of parliament in the context of an anti-corruption investigation. Looking ahead, we will maintain NABU's exclusive authority to investigate acts of corruption by high-level officials. To monitor progress made in implementing the anticorruption legal framework, NABU will continue publishing statistics related to investigations of acts of corruption by high-level officials under the NABU's jurisdiction, on a webpage freely available to the public (in line with the revised template detailed in paragraph 99 of the TMU) and on a quarterly basis. By end-April 2017, the President, Parliament, and the Cabinet of Ministers will each nominate one expert for the commission of external control, in line with Article 26.6 of the NABU Law. The commission will approve the terms of reference for the annual external audit of NABU by end-June 2017, in agreement with IMF staff. Based on the analysis conducted by the auditors, the audit report will include clear and prioritized recommendations for improvements of the bureau's operations, in line with international best practices. In case auditors unanimously conclude that the criteria referred to in Article 6.4.11 of the NABU Law are met, they will include a detailed rationale and recommendation in their report. The audit report will be finalized by end-October 2017 and appended to the subsequent NABU bi-annual report.

- c. **Anti-corruption court.** To ensure that prosecution of acts of corruption by senior officials receives a specialized and prioritized judicial response, we will operationalize the anti-corruption court established by the July 2016 Law on the Judiciary, consistent with the European Convention of Human Rights and other standards of the Council of Europe. To this end, by mid-April 2017 we will submit relevant legislation to parliament, and we expect this legislation to be adopted by parliament by mid-June 2017 (a new **structural benchmark**). This legislation will include provisions to ensure budgetary autonomy and adequate security of the anti-corruption judiciary framework and establish the selection process for anti-corruption judges. Building upon the experience with NABU and SAP, it is critical that the selection process is seen as independent and trustworthy by the public. In line with Article 33.2 of the Law on the Judiciary, specific requirements will be introduced in the proposed legislation to ensure that applicants to the position of anti-corruption judges are not only of impeccable reputation, and have high professional qualities, but also possess relevant specific skills necessary to adjudicate criminal cases related to corruption. In this regard, the legislation will set out the procedure, including tests and tasks, for the assessment of the specific professional skills of applicants, which will be based on a transparent evaluation of candidates by the High Qualification Commission of Judges with the support from respected experts with recognized ethical standards and experience in anti-corruption prosecution or adjudication, including potential engagement of experts with relevant experience in other countries. This procedure should be in line with the Ukrainian Constitution and the standards of the Council of Europe. The assessment

of high integrity and ethical standards shall be conducted with the participation of the Civic Integrity Council as provided by the Law on the Judiciary. In line with Article 81 of the Law on the Judiciary, this selection process will ensure that for each available position, an applicant of impeccable reputation, relevant specific skills, and high professional qualities is timely selected by the High Qualification Commission of Judges, and presented by the High-Council of Justice to the President of Ukraine for appointment by mid-January 2018. The anti-corruption court will begin its operations by end-March 2018.

- d. **AML implementation.** AML/CFT on-site inspections of banks targeted on the implementation of measures related to PEPs start to bear fruits, by both increasing the implementation of requirements by banks, and the suspicious transaction reporting to the FIU. The NBU has implemented enforcement actions on 13 banks since July 2016, including the revocation of a bank's license, notably for failure to implement requirements related to PEPs. In 2016, the FIU disseminated 71 cases involving PEPs to NABU, including 24 members of Parliament. We will ensure that the legal and institutional measures contemplated in paragraph 36e. of the September MEFP are implemented by end-March 2017. In particular, we will adopt amendments to the legal framework to ensure a three-tier reporting system: (i) suspicious transaction reports as defined by the FATF, (ii) threshold based reporting of cash transactions and international funds transfers, and (iii) mandatory reporting of transactions related to high-risk jurisdictions and politically exposed persons, and we will strengthen the operational capacity and integrity of the Financial Intelligence Unit (FIU). In the context of amendments to the AML legal framework, we will also ensure, in agreement with Fund staff, that the definition of the persons related to PEPs is consistent with the risk-based approach encouraged by the FATF standard, and that proportionate and dissuasive sanctions can be implemented by the NBU in case of breaches of compliance with the AML framework. To monitor its contribution to anticorruption efforts, the FIU will continue publishing quarterly statistics on the information it disseminates to the NABU (in line with the template detailed in para. 99 of the TMU). The NBU will continue to conduct at least 4 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. By January 2018, when sanctions are imposed for breaches of AML/CFT requirements, the NBU will publish information on the name of the bank, the enforcement actions imposed, and a brief description of the breaches identified, while allowing case-by-case exceptions particularly where publication jeopardizes the stability of financial markets or an on-going investigation.
- e. **Business ombudsman.** Parliament is expected to adopt legislation on the Business Ombudsman in line with paragraph 36g of the September 2016 MEFP by end-March 2017. Since the start of its operations, the Business Ombudsman received more than 1,450 complaints, with a 95 percent satisfaction rate from complainants and a direct financial impact from its interventions estimated at more than UAH 8 billion.

Business climate

27. We remain firm in our efforts to improve the business climate to attract investment and boost the growth potential of our economy. Recent achievements include adoption of amendments to the law on inspections to increase the transparency and efficiency of company inspections and adoption of legislation to streamline the export of services. Further initiatives to strengthen our business environment include:

- a. **Deregulation and licensing.** The CMU has recently adopted a number of decisions abolishing a large number of regulatory acts, especially in the areas of telecommunications and agriculture. Moreover, we have revised our deregulation action plan to reflect progress to date and to refocus our efforts. In particular, we expect implementation of items 7, 8, 73, 83, and 108 of the new plan, as well as adoption of the law on the electricity market, by end-March 2017. Remaining items will be implemented in line with the commitments in the action plan. In parallel, we are conducting a rolling review of regulatory burdens in the energy, infrastructure, construction, and agriculture sectors. The CMU will adopt specific proposals for reform in each of these areas by end-April 2017. Finally, the CMU will adopt all remaining licensing conditions by end-March 2017. In this context, we will also take the necessary steps to ensure that the Single State Register of legal entities and natural persons becomes operational by end-June 2017.
- b. **Land reform.** Liberalizing the land market, including the sale of agricultural land, remains essential to boost Ukraine's growth potential. To this end, we have established a working group with relevant ministries that, in collaboration with the World Bank, will draft legislation to open up the land market and allow the sale of land under adequate safeguards. Parliamentary approval of the law on agricultural land circulation is expected by end-May 2017 (a modification and new deadline for the missed end-September 2016 **structural benchmark**), allowing for the current moratorium on the sale of agricultural land to expire by the end of 2017, thus allowing for the sale of state-owned and private land to start immediately thereafter. We will also launch a public information campaign to explain the benefits of this reform.

State-Owned Enterprise Reform

28. Albeit with some delays, we continue to make progress with the implementation of our SOE-reform strategy. Specific near-term measures include:

- a. **Oversight of SOEs fiscal risks.** Building on recent technical assistance by the IMF, we are strengthening through adequate legislation the fiscal risks management unit in the MoF, which is tasked with monitoring and analyzing SOE fiscal risks. We will prepare an initial analysis of these fiscal risks by end-April 2017 and expect to have a comprehensive statement of fiscal risks emanating from the SOE sector included in the 2018 budget documentation and published on the MoF website.
- b. **SOE governance and reform.** Our comprehensive strategy to reform and increase the sector's efficiency includes:

- i. **Governance.** Following adoption of the SOE corporate governance law, the CMU will adopt the decisions regulating the establishment of supervisory boards by end-March 2017. We will complete the appointment of independent supervisory boards in the largest 15 SOEs by end-June 2017. Moreover, we expect audit reports for the largest SOEs, prepared by reputable auditors that were selected on the basis of the CMU decree on criteria for auditor selection in large SOEs, to be completed by end-June 2017. We continue to explore options for the establishment of a single national Holding Company that will be tasked with managing strategic commercial SOEs.
- ii. **Triage of all SOEs.** We continue with the triage of all SOEs in consultation with IMF staff. SOEs without a clear national strategic interest will be privatized or liquidated. By end-August 2017, the Cabinet will adopt, and publish on the MoEDT website, the triage and transfer of SOEs to the State Property Fund of Ukraine (SPFU) (a new deadline for this **structural benchmark**, reset from end-October 2016).
- c. **Liquidation of SOEs.** On the basis of the results of the triage, we plan to centralize the liquidation of non-operating SOEs under the SPFU. With this intent, the SPFU, in consultation with relevant ministries, is preparing a draft law that will enable the SPFU to liquidate SOEs with zero assets or where assets are smaller than liabilities, under streamlined procedures. In this context, we will conduct an analysis of the bankruptcy law as relevant for SOEs and introduce the necessary changes where needed. We expect parliament to adopt this draft bill by end-June 2017.
- d. **Privatization.** While we have made limited progress to date in the privatization of large SOEs, we recognize the need to accelerate this process to raise Ukraine's growth potential. Key elements in our privatization strategy include:
 - i. **Improving the legal framework.** Parliament will adopt amendments to the privatization law to improve transparency and safeguards, and to further streamline the privatization process for medium-sized enterprises by end-August 2017 (a new deadline for this **structural benchmark**, reset from end-December 2016).
 - ii. **Creating a larger pipeline of enterprises for privatization.** Based on the triage and facilitated also by the adoption of legislation to reduce the list of companies banned from privatization, expected by end-June 2017, we will develop a schedule for transferring additional SOEs from the line ministries to the SPFU. The shares of all companies that are planned to be offered for sale in 2017 will be transferred to the SPFU by end-March 2017.
 - iii. **Privatization of small SOEs and assets.** We will streamline and accelerate the privatization of small SOEs and of thousands of small assets (buildings, machinery, etc.) currently in state hands, including by holding

electronic auctions through our Prozorro system. We expect to conduct first auctions in this new platform by end-June 2017.

- iv. **Privatization of large SOEs.** We remain committed to the privatization of PJSC Odessa Portside Plant and will implement the necessary measures, including addressing the identified balance sheet shortcomings, to attract reputable international investors and complete its privatization by the first half of 2017. In parallel, we will initiate the privatization of a number of large SOEs identified for privatization by end-September 2017, including PJSC Centrenergo, Turboatom, whose shares have already been transferred to the SPFU, and the regional energy distribution companies, obloenergosp, whose shares will be transferred to the SPFU by end-April 2017. Similarly, we expect the adoption of legislation allowing for the full privatization of Ukrspirits, Ukraine's state-owned producer of spirits, which consists of about 150 related SOEs, by end-March 2017, with the objective to have the contest sale completed by end-September 2017.

Table 2. Ukraine: Prior Actions and Structural Benchmarks

Prior Actions	Status	Completion date
Parliamentary approval of the 2017 budget and supporting legislation consistent with the program target of 3.1 percent of GDP (as specified in ¶18).	Met	
Resolution of all large banks that do not meet the minimum capital requirements (as specified in ¶8).	Met	
Revise the Public Service Obligations (CMU Resolution 758) to introduce an interim mechanism to automatically adjust gas and heating tariffs on a semi-annual basis if tariffs deviate from full cost-recovery levels (based on import parity as defined in the TMU) by 10 percent or more (as specified in ¶24a).	Met	
Reduce consumption norms from 5.5 to 5.0 cm per m ² for gas for individual heating, from 65 to 51 kwh per m ² for electricity used for individual heating, and from 0.0548 to 0.0431 Gcal per m ² for centralized heating effective May 1, 2017 (as specified in ¶23).]	Met	
Enforce the filing of asset declarations for 2015 by high-level officials in accordance with the law on prevention of corruption, report cases of non-filers to NABU, and make publicly available the submitted declarations (as specified in ¶26a).	Met	
Proposed New Structural Benchmarks	Status	Completion date
Selection of an international reputable firm on the basis of a transparent process, that negotiates the restructuring and collection terms of PrivatBank's impaired loans, on the basis of international best practices; and selection of a reputable international audit firm to conduct for the next two years a semi-annual independent loan review of PrivatBank's loan portfolio (in accordance with the legal and NBU regulatory framework), with the aim of properly monitoring asset value recovery (as specified in ¶8iv).		April 15, 2017
Parliamentary approval of pension legislation (as specified in ¶21a).		End-April 2017
Parliamentary approval of legislation to establish a new civil service responsible for investigation of financial offences under the MoF to replace the current tax police and to consolidate responsibilities of fighting financial offenses against the State into a single agency, while avoiding duplication of functions (as specified in ¶20e).		End-April 2017
Parliamentary approval of a law on agricultural land circulation allowing for the current moratorium on the sale of agricultural land to expire by the end of 2017, thus allowing for the sale of state-owned and private land to start immediately thereafter (as specified in ¶27b).		End-May 2017

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

Proposed New Structural Benchmarks	Status	Completion date
Parliamentary approval of legislation to establish an anti-corruption court (as specified in ¶26c).		June 15, 2017
Revise parameters of the household utility subsidies (HUS) system to improve targeting; introduce an adjustment to the social norm for off-peak heating months; and apply a capacity-based distribution tariff for gas and heat that would shift some of the costs to the summer, all effective May 1, 2017, thereby limiting household utility subsidy outlays to UAH 47 billion in 2017 (as specified in ¶23).		End-July 2017
Adopt CMU Resolution to monetize utility subsidies at the level of utility companies (as specified in ¶24b).		End-August 2017
Establish a centralized database in the MoF of recipients of social assistance (as specified in ¶21d).		End-December 2017
Previous Structural Benchmarks	Status	Completion date
Adjust the parameters of utility-related social assistance programs, including the HUS benefits formula, to ensure that benefits remain within the allocated fiscal envelope (September 2016 MEFP ¶31a).	Prior action (modified)	End-September 2016
Submit law on agricultural land circulation to parliament (September 2016 MEFP ¶38d).	Not met	End-September 2016 Modified and reset for end-May 2017
Parliament will approve amendments to legislation, consistent with IMF staff advice, to strengthen the corporate insolvency regime (September 2016 MEFP ¶20).	Not met	End-September 2016 Reset for end- September 2017
Parliament will approve a law which strengthens the provisions in the Code of Civil Procedure and the Code on commercial Procedure on Order for Payments for domestic transaction and on garnishment of bank accounts (September 2016 MEFP ¶37).	Not met	End-September 2016 Reset for end- September 2017
Revise the Public Service Obligations (CMU Resolution 758) to introduce an interim mechanism to adjust gas and heating tariffs on a quarterly basis if tariffs deviate from full cost-recovery levels (based on import parity as defined in the TMU) by 10 percent or more (September 2016 MEFP ¶33a).	Prior action (modified)	End-October 2016
Ensure all high-level officials filed their assets and income declarations, as defined under Article 46 of law 2014/49 for the calendar year 2015 and their full disclosures freely available to the public on a single website shortly after submission (September 2016 MEFP ¶36c).	Prior action	End-October 2016
Cabinet of Ministers approval and publication in the MEDT website of the completed triage of all SOEs, dividing them into companies to (i) remain under management of the State (including SOEs that are located in territories currently not under the control of the government); (ii) privatize; or (iii) liquidate; and transfer to the SPFU those SOEs incorporated in the privatization plan for 2016 (September 2016 MEFP ¶39c).	Not met	End-October 2016 Reset for end-August 2017

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

Previous Structural Benchmarks	Status	Completion date
Parliamentary approval of legislation ensuring that the NABU has: (i) the use of 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; and that (ii) the registration of pre-court cases and of investigative judges' rulings pertaining to NABU should be protected from leakage of information related to ongoing investigations, by restricting access to the information to NABU and SAPO officers until the investigation of the case is completed, or the case is closed (September 2016 MEFP ¶136a).	Not met	End-November 2016 Reset for end-May 2017
Parliamentary approval of legislation to: (i) gradually adjust the statutory retirement age and further reduce the scope for early retirement; (ii) tighten the eligibility criteria for the minimum pension; (iii) consolidate pension legislation, which is now spread across about two dozen laws, and ensure a single principle for providing pensions without privileges for any occupation (with the exception of the military); (iv) expand the base for social security contributions; (v) ensure equitable tax treatment of pensions; and (vi) better link benefits to contributions, also to encourage the declaration of actual incomes. In addition, we will separate various categorical pension supplements from the labor pensions, bring their financing from the pension fund to the state budget and improve their targeting starting from 2017 (September 2016 MEFP ¶129a).	Not met	End-December 2016 Reset and modified for end-April 2017
Parliamentary approval of amendments to the privatization law to improve transparency and safeguards, and to further streamline the privatization process (September 2016 MEFP ¶139e).	Not met	End-December 2016 Reset for end-August 2017
Adopt legislation to merge the customs and tax administration into a single legal entity (September 2016 MEFP ¶127a).	Not met	End-December 2016 Reset for end-March 2017

Table 3. Ukraine: Proposed Schedule of Purchases Under the Extended Arrangement

Availability date	Amount of purchase			Conditions
	Millions of SDRs	Millions of US\$ 1/	Percent of quota 2/	
March 11, 2015	3,546.00	4,872.00	258.45	Board approval of extended arrangement
June 15, 2015 3/	1,182.10	1,650.00	86.16	First review and end-March 2015 performance criteria
September 15, 2015 3/	716.11	999.80	35.60	Second review and end-December 2015 performance criteria
November 15, 2016	734.05	987.34	36.49	Third review and end-December 2016 performance criteria
May 15, 2017	1,418.48	1,906.91	70.51	Fourth review and end-March 2017 performance criteria
August 15, 2017	952.49	1,279.62	47.35	Fifth review and end-June 2017 performance criteria
November 15, 2017	952.49	1,278.81	47.35	Sixth review and end-September 2017 performance criteria
February 15, 2018	711.57	954.67	35.37	Seventh review and end-December 2017 performance criteria
May 15, 2018	711.57	954.58	35.37	Eight review and end-March 2018 performance criteria
August 15, 2018	711.57	954.78	35.37	Ninth review and end-June 2018 performance criteria
November 15, 2018	711.57	955.15	35.37	Tenth review and end-September 2018 performance criteria
Total	12,348	16,794	614	

Source: IMF staff estimates.

1/ For 2015–18, the average USD/SDR rates used in this table are: 1.399, 1.396, 1.362, and 1.361, respectively.

2/ For 2015, Ukraine's previous quota of SDR 1,372 million applies. Ukraine's new quota of SDR 2,011.8 million became effective in February 2016. The total amount of SDR 12,348 million is equivalent to 614% of the new quota.

3/ The second purchase took place on August 4, 2015 and the third purchase took place on September 16, 2016.