Macro-Financial Assistance for Ukraine
Loan Facility from the European Union of up to 610 million EUR

MEMORANDUM OF UNDERSTANDING

between

THE EUROPEAN UNION
as Lender

and

UKRAINE
as Borrower
MEMORANDUM OF UNDERSTANDING
between THE EUROPEAN UNION
and UKRAINE

1. On 12 July 2002, the Council of the European Union adopted a decision to make available to Ukraine macro-financial assistance of up to 110 million EUR in the form of a loan (Decision 2002/639/EC). On 7 July 2010, the European Parliament and the Council of the European Union adopted a decision to make available to Ukraine macro-financial assistance of up to 500 million EUR in the form of a loan (Decision 646/2010/EU). The objective of this assistance is to ease Ukraine's external financing constraints, alleviate its balance of payments and budgetary needs and strengthen its foreign exchange reserve position. This assistance from the European Union is complementary to the resources provided to Ukraine by International Financial Institutions and bilateral donors in support of the authorities' economic stabilisation and reform programme.

2. The disbursement of the assistance will be conditional upon a satisfactory track record in the implementation of the Arrangement to be agreed between Ukraine and the International Monetary Fund (hereafter referred to as "the IMF"), as well as upon a positive assessment by the European Commission (hereafter referred to as "the Commission") on behalf of the European Union, of progress made with respect to economic stabilisation and structural reforms.

The macroeconomic and structural adjustment policy conditions attached to this assistance are based on the economic stabilisation and reform programme endorsed by Ukraine's authorities and are consistent with agreements reached by Ukraine with the IMF.

The quantitative performance criteria attached to the EU assistance will be those stipulated under the Arrangement to be agreed between Ukraine and the IMF. The quantitative performance criteria are currently: ceiling on the cash deficit of the general government; ceiling on the cash deficit of the general government and Naftogaz; floor on cumulative change in net international reserves; ceiling on cumulative change in net domestic assets; ceiling on publicly guaranteed debt; and the non-accumulation of external debt payments arrears by the general government. Accordingly, before the release of each instalment of this assistance, the Commission, in co-operation with the national authorities and IMF staff, will verify that the quantitative performance criteria have been adequately respected or new understandings reached.

3. The assistance will be disbursed in four instalments. The first and second instalments (of 100 million EUR and 10 million EUR, respectively) shall be disbursed under the Decision 2002/639/EC and the third and fourth instalment (of 250 million EUR each) under the Decision 646/2010/EU. The first instalment of the assistance will be disbursed upon entry into force of this Memorandum and the corresponding Loan Agreement, provided that Ukraine receives disbursements under the Arrangement to be agreed with
the IMF. The disbursement of the second instalment under each Decision shall not take place earlier than three months after the release of the first instalment under the same Decision. The second instalment under the Decision 2002/639/EC can be disbursed on the same date as the first instalment under the Decision 646/2010/EU, as long as such instalments have the same maturity, grace period (if any), interest rate and repayment profile.

Upon receipt of compliance statements by the authorities of Ukraine and before the release of each of the second and subsequent instalments, the Commission will evaluate, in co-operation with the authorities of Ukraine and IMF staff, progress made with respect to the fulfilment of the quantitative performance criteria and a selected number of structural reform criteria. In this evaluation, particular attention will be paid to reforms in public finance management and a number of further structural reform areas. The policy measures and frame of reference for this evaluation are made explicit in Annex I. It may be adjusted as appropriate at a later stage.

4. The effective payment of different instalments shall be subject to the signature of the corresponding Loan Agreement by the parties and its entry into force.

5. The Commission will make available the proceeds of the assistance to Ukraine through the National Bank of Ukraine, which acts as the Borrower’s Agent in the context of this EU macro-financial assistance.

The authorities of Ukraine undertake to timely and fully service all financial obligations stemming from loans provided or guaranteed by the European Union.

During the implementation of the assistance, the authorities of Ukraine shall supply the Commission with all information that is relevant for the monitoring of its economic and financial situation and that will be needed for the assessment of the quantitative performance criteria and for the review of progress in structural reforms. In particular, the authorities will supply to the Commission on a timely basis the relevant information as set out in Annex II.

6. The Commission, represented by its own agents or its duly mandated experts, shall have the right to carry out operational assessments of the administrative procedures and financial circuits of Ukraine and of the Agent that relate to the management of EU macro-financial assistance.

7. An independent ex-post evaluation of the assistance may be carried out by the Commission or its duly authorised representatives. The authorities of Ukraine are committed to supply all necessary information on the occasion. The evaluation report will be made available to them for comments.

8. The authorities will ensure, as appropriate, close co-operation with the European Commission. Confidential information under this Memorandum shall be exchanged in accordance with the Agreement between Ukraine and the European Union on the security procedures for the exchange of classified information of 13 June 2005.

9. This assistance is implemented on the understanding that the authorities of Ukraine will continue to respect the Rule of Law, Democracy, and Human Rights.
10. Pursuant to Parliament and Council Decision 646/2010/EU of 7 July 2010, this assistance shall apply for two and a half years starting from the first day after the coming into force of the MoU. This date shall be the final date for a disbursement of any instalment of the loan subject to fulfilment of conditions laid down in Annex I of the Memorandum of Understanding.

11. Annexes I and II are an integral part of this Memorandum.

12. All notices in relation with the present Memorandum shall validly be given if in writing and sent to:

For the European Union
European Commission
Directorate General for
Economic and Financial Affairs
Rue de la Loi, 170 - CHAR 11/248
B-1040 Brussels

For Ukraine
Ministry of Finance of Ukraine
12/2 Hrushevskyi Street, Kyiv
01008 Ukraine
For the attention of: Minister, Deputy Minister, and Head of Debt and International Financial Policy Department

With copy to:

National Bank of Ukraine
9 Instytutska Street, Kyiv
01601 Ukraine
For the attention of: Governor or Deputy Governor

13. The present Memorandum shall become effective following the signature by Ukraine and the European Union and following receipt by the European Union of written notification by Ukraine of fulfilment of internal procedures envisaged by the law of Ukraine.

14. This Memorandum may be amended upon mutual agreement of the parties in form of a written Addendum. Such Addendum shall be an integral part of the Memorandum and will become effective according to the procedure to be established by such Addendum.
This Memorandum of Understanding has been signed in four originals in the English language.

For UKRAINE
as Borrower
Represented by

For the EUROPEAN UNION
as Lender
Represented by
the EUROPEAN COMMISSION

Signed in Kyiv on 25 February 2013 by
Yuriy Kolobov
Minister of Finance

Signed in Brussels on 25 February 2013 by
Olli Rehn
Vice-President for Economic and Monetary Affairs and the Euro

Signed in Kyiv on 26 February 2013 by
Ihor Sorkin
Governor of the National Bank of Ukraine
Structural Reform Policy Measures – Part I

At the time of the Commission review that will precede the decision with respect to the disbursement of the second and third loan instalments (which can be disbursed on the same date), the authorities are committed to have fulfilled the following conditions:

Public Finance Management

1. Consistent with the Law of Ukraine “On carrying out public procurement” adopted in July 2010, consolidate progress in establishing a system of public procurement based on the principles of transparency, competition and non-discrimination among tenderers. With a view to increasing transparency, the Ministry of Economy will publish on a quarterly basis data on the number and the value of competitive procurement procedures and sole-source procurement procedures.

2. As stipulated by the the Law of Ukraine “On carrying out public procurement”, make the Anti-Monopoly Committee operational as the authority to handle appeals in the sphere of public procurement, including by establishing within the Committee an appropriately staffed unit capable of effectively dealing with complaints submitted by aggrieved bidders.

3. Adopt a national anti-corruption strategy that is in line with international best practice and a State Programme with time-bound deliverables to implement it.

4. With a view to strengthening public internal financial control and audit, adopt a strategy for staff training at the different levels of government (central and municipal level, including internal audit services) and for certification of internal auditors.

5. Submit to the Parliament a legislative proposal ensuring that the Accounting Chamber of Ukraine has the Authority to audit not only budget expenditures, but also revenues in line with the standards of the International Organisation of Supreme Audit Institutions (INTOSAI), in particular Principle 3 of the Mexico Declaration on SAI (Supreme Audit Institution) Independence.

Trade and Taxation

6. Refrain from introducing trade-distorting measures and fully apply Ukraine’s WTO commitments.

7. Introduce an up-to-date product coding system for foreign trade purposes based on the Harmonised System 2007.

8. Ensure that all VAT refund arrears are cleared and that all legitimate VAT refund claims are paid in cash, or netted out against VAT obligations of the taxpayer in question, in a timely manner.
9. Introduce in VAT legislation the provision that any VAT refund arrears carry an appropriate penalty interest of at least 120% of the NBU discount rate. All legitimate VAT refund claims that have not been settled within a period adding up to a maximum of 74 days after submission of the VAT refund claim to the tax authorities shall be considered in arrears.

10. With a view to preventing the future occurrence of VAT refund arrears, make significant progress towards strengthening the VAT administration system. In particular, ensure timely VAT refunds through the operation of an automatic VAT refund system and risk-based audits.

**Energy Sector**

11. Consistent with the Economic Reform Programme, increase substantially the overall collection rate of Naftogaz through better enforcement of payments discipline, notably among communal utilities. To this end: open a special purpose account for centralised collections from communal utilities, through which the corresponding balances for the gas component are directly forwarded to Naftogaz; and substantially expand the utilisation of individual gas meters.

12. In order to compensate vulnerable households for the increase in gas prices, while improving collection rates, strengthen in a targeted manner the social safety net.

13. Reach “Candidate” status in the Extractive Industries Transparency Initiative to underpin transparency in the energy sector.

**Financial Sector**

14. Amend legislation, notably the accounting law, so as to ensure the application of the International Financial Reporting Standards to all financial market participants by 2014 at the latest.
Structural Reform Policy Measures – Part II

At the time of the Commission review that will precede the decision with respect to the disbursement of the fourth loan instalment, the authorities are committed to have fulfilled the following conditions:

Public Finance Management

1. Adopt an appropriate set of Public Internal Financial Control standards (based on the principles of managerial accountability and functionally independent internal audit).

2. Continue to make progress towards establishing a system of public procurement based on the principles of transparency, competition and non-discrimination among tenderers.

3. Implement comprehensive anti-corruption legislation in line with the recommendations made by the Council of Europe’s Group of States against Corruption (GRECO) and other international standards.

4. Increase the financial resources allocated to the external audit function to a level that will ensure an appropriate increase in the number and quality of audits.

Trade and Taxation

5. Refrain from introducing trade-distorting measures and fully apply Ukraine’s WTO commitments.

6. Consistent with the Economic Reform Programme, ensure that customs valuation practices are fully in line with WTO standards (Agreement on Implementation of Article VII of the GATT 1994). In particular, the customs value of goods will be determined mainly on the basis of declared transaction values (as defined in Article I of the Agreement on Implementation of Article VII of the GATT 1994) and, in case the customs value cannot be determined in this way, working down on a consecutive basis from Method 2 to Method 6 (as per Articles 2 through 7), with Method 6 being used only in exceptional cases in which the customs administration has justified reasons to doubt the truthfulness or accuracy of the declared value and cannot determine the customs value on the basis of Methods 1 through 5. Compliance will be measured by a diminishing share of customs transactions cleared based on Method 6, on the basis of government sources and independent reports.

7. Continue to ensure that all legitimate VAT refund claims are paid in cash, or netted out against VAT obligations of the taxpayer in question, in a timely manner.
Energy Sector

8. Achieve substantial progress in the implementation of Ukraine's obligations under the Energy Community Treaty, which include ensuring compliance with EU Directive 2003/55/EC, which notably foresees the separation of the production, distribution and transport in the national gas sector. Progress will be monitored by the European Commission, taking into account relevant implementation reports by the Energy Community Secretariat.

9. Further increase the overall collection rate of Naftogaz through improved payments discipline.


Financial Sector

11. In line with the Ukrainian commitment in the EU-Ukraine Association Agenda, prepare the implementation of EU legislation concerning financial services, as mentioned in the Annex of the relevant Co-operation Chapter of the Association Agreement, in particular through adoption of a strategic multi-year plan. This strategic plan would define the priority areas for legislative approximation, provide a list of specific steps and measures to be taken and outline the timeline for their implementation.
Monitoring System

During the implementation of the European Union’s assistance, the following indicators and reports shall be provided to the Commission by the relevant authorities on a quarterly basis.

1. Monitoring of macroeconomic and financial developments and policies

- Level and composition of general government revenue and expenditure, including extra-budgetary public funds (e.g. those related to the social security system) and state-owned enterprises, including Naftogaz
- External debt, including external arrears, as per the IMF Arrangement to be agreed with Ukraine
- General government debt and publicly guaranteed debt, including payment arrears, based on the definition used in the IMF Arrangement to be agreed with Ukraine
- Interest payments on external debt and principal repayments on external debt
- Interest payments on general government debt and publicly guaranteed debt and principal repayments on general government debt and publicly guaranteed debt
- Projections of interest and principal on external debt falling due over the next four quarters
- Interest and principal on general government debt and publicly guaranteed debt falling due over the next 12 quarters
- Payments (disbursements, interests and amortisation) made on publicly guaranteed loans by the following state-owned enterprises or agencies: Naftogaz, UkrAvtoDor, the State Mortgage Institution and the national agency in charge of preparing and conducting Euro 2012
- Provide, on a quarterly basis, monthly data on VAT refunds in the following format: (i) beginning stock of refund requests; (ii) refund requests paid in cash; (iii) refunds netted out against obligations of the taxpayer; (iv) denied requests; (v) new refund requests; (vi) end-of-period stock of requests; and (vii) stock of VAT refund arrears (unsettled VAT refund claims submitted to the Ministry of Revenues and Duties more than 74 days before the end of period).
- Collection rates of Naftogaz, by type of customer (including an appropriate span of historical data for comparison purposes)
- Number and total financial value of public procurement procedures and breakdown into sole-source and competitive procedures (including an appropriate span of historical data for comparison purposes)
- Share of customs transactions cleared on the basis of values declared by importers / exporters (“Method 1”) and on the basis of reference values (“Method 6”) (including an appropriate span of historical data for comparison purposes).

2. Monitoring of structural policies

- Progress report on public finance reform and administration (quarterly)
- Progress report on banking sector reform (quarterly)
3. Publication of economic data

In addition, the following information shall be published in a timely manner, and in at least the same frequency and degree of detail as previously, by the relevant authorities:

- GDP or national income (yearly and quarterly)
- Main demand components of GDP (yearly and quarterly)
- Industrial production (monthly)
- Wages (monthly)
- Employment and unemployment rates (monthly)
- Price level indicators (monthly)
- Interest rates (short and long term, monthly)
- Foreign trade (monthly)
- Balance-of-payments (monthly and quarterly)
- Official international reserves (monthly)
- Exchange rates