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Facilitating Cooperation between Credit Bureaus in Ukraine

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Facilitating Cooperation between Credit Bureaus in Ukraine

Executive Summary

The key question of this paper is how the performance of the credit reporting system in Ukraine could be improved. In answering this question, we concentrate on the private bureaus active in Ukraine and in a first step identify the main impediments, data fragmentation and lack of data.

While a number of stakeholders, in particular official institutions, see the predominantly private ownership of the sector as the main problem, and consequently as a key to a solution, we do not agree. First, we observe that the ownership structure with a number of private bureaus that are in fierce competition with each other is not unusual. On the contrary, a number of countries in the region exhibit a similar competitive structure. Second, there is empirical evidence that a predominantly private ownership is positively correlated with the legal efficiency of the credit reporting system.

Thus, other mechanisms need to be found to overcome data fragmentation and lack of data. We believe that cooperation initiatives among the bureaus are a major way ahead in this respect. This message has also been partially received by the main stakeholders, as plans to form an industry association of credit bureaus and to improve data exchange are currently under discussion.

We think these plans are a good start, but need to be supplemented by further moves. Specifically, the hopefully forthcoming industry association could be a platform to launch further initiatives, such as the development of a "Code of Conduct", which contains well-established and recognised fundamental principles in credit reporting. The association would also be an ideal institution to initiate a regular reporting process in form of a "credit bureau dashboard", which would ultimately contribute to a better understanding of the market by its users and increase competition among credit bureaus. Increasing financial literacy of the population with respect to credit reporting and highlighting its benefits for an improved access to finance should also be a major focus of the association.

In order to overcome the problem of data fragmentation mentioned above, cooperation initiatives that try to achieve a higher degree of standardisation and harmonisation of the data exchange process look very promising. However, such initiatives will probably only be realistic in the medium-term, when the databases of the bureaus are more mature and the market has reached a certain level of stability.

To sum up, the implementation of these initiatives would improve data quality and coverage, increase transparency and, most importantly, trust in the system of credit reporting. This will improve the usefulness of the system to the user-side (i.e. banks), and ultimately good borrowers will benefit from an improved access to finance. At the same time, these initiatives will likely change the vector of competition between the bureaus themselves, as market forces will bring changes into an increasingly mature market.

It is very likely that in the end, Ukraine's credit reporting market structure will mirror other, more developed markets insofar as a small number of players dominate a competitive market. But this will be the result of a normal market process, accelerated by cooperation, and not imposed by regulatory force.

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Table of contents

Executive Summary 3

1. Introduction 5

2. The Credit Bureau Sector: Structure, Problems and Solutions 5
   2.1 Market Structure 5
   2.2 Existing Problems 7
   2.3 Possible Solutions 8

3. Facilitating Cooperation between Credit Bureaus 9
   3.1 Assessment of Current Plans 10
   3.2 Extending Cooperation: Further Recommendations 13

4. Outlook 16

References 17

1. Introduction

Efficient and effective information sharing by creditors is an important element of the financial infrastructure of a country, and helps to facilitate access to finance especially for consumers and small- and medium-sized companies. While a credit reporting system is operational in Ukraine, its performance could be improved. Our previous policy paper "Improving the Framework of Credit Bureaus' Operations: Key Recommendations" identified impediments for an effective work of private bureaus and possible ways how to improve the situation. A key insight was that this should be considered a common task for several stakeholders, namely the government as regulator, commercial banks as providers and users of information and the private credit bureaus.

In this follow-up paper, we narrow the focus on the tasks for private credit bureaus. In particular, we try to answer the question what should they do in order to improve the functioning of the sector? Among possible ways to improve the situation, better cooperation between credit bureaus seems to be a promising way ahead. However, simple as it sounds, this is not a straightforward task, as the preservation of a genuinely competitive landscape is extremely important. Thus, the question is where, how and to what extent cooperation between competing entities makes sense from an overall economic point of view.

The structure of the paper is as follows: In chapter 2 we provide a short overview of the credit reporting system in Ukraine in an international context. This helps to frame the discussion from a wider angle. Afterwards, we analyse the main existing problems in the sector, and discuss possible general ways to overcome them. Facilitating cooperation will play a key role in this regard. Chapter 3 thus has two objectives: First, it analyses and assesses cooperation plans currently under discussion in Ukraine, and then proposes further recommendations on how to improve the situation. Respective international experience and evidence is also included. Chapter 4 then concludes.

2. The Credit Bureau Sector: Structure, Problems and Solutions

2.1 Market Structure

Ukraine's credit reporting infrastructure is mainly based on multiple private credit bureaus, which compete for business alongside a public credit registry that is run by the National Bank of Ukraine. Such a market structure is not unfamiliar in other transition countries, as the following table shows, which is based on a survey[1] conducted by the EBRD:

[1] The survey does not include Ukraine.

Table 1

Transition countries: Main institutional form of credit reporting systems (2011)

	Central bank public registry only	Both public registry and private bureau (but registry dominant)	Public registry and private bureau co-existing	Both public registry and private bureau (but bureau dominant)	Single private bureau only	Multiple private bureaus / registry – competitive environment
Bosnia and Herzegovina			✔			
Bulgaria		✔				
Croatia					✔	
FYR Macedonia		✔				
Georgia					✔	
Hungary					✔	
Kazakhstan					✔	
Kyrgyz Republic					✔	
Latvia			✔			✔
Mongolia*					✔	
Poland						✔
Romania			✔			✔
Russia						✔
Serbia**					✔	
Slovak Republic			✔			
Turkey			✔			

Source: EBRD (2012)

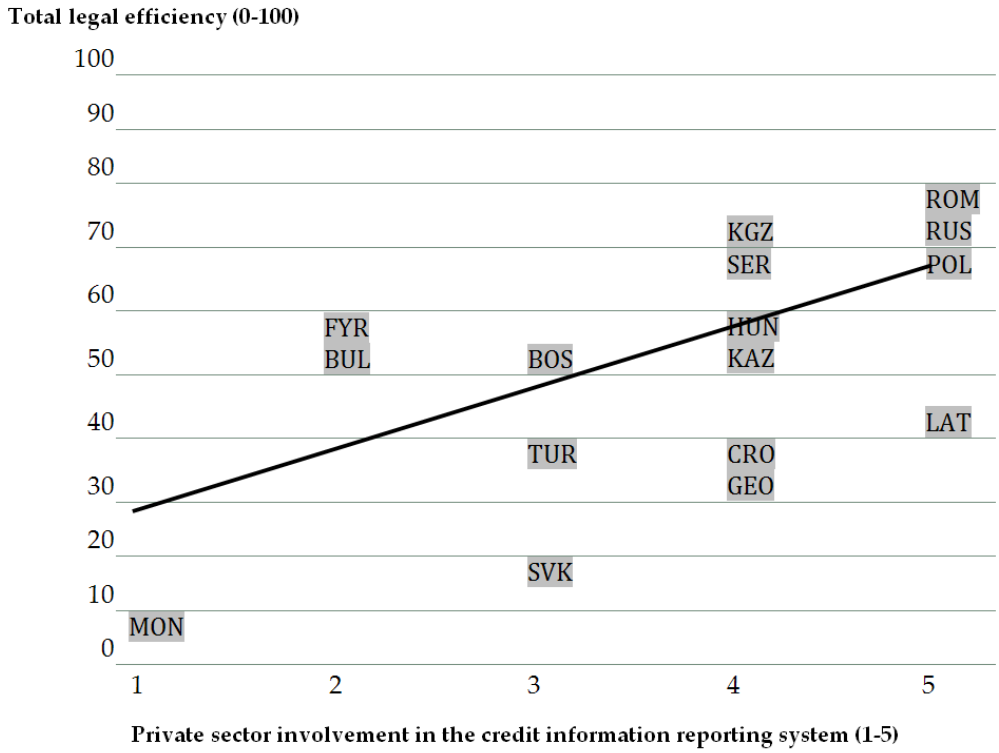
** This is a prospective interpretation of the reformed system currently under development*
*** Excluding Kosovo*

While experience in the region is clearly mixed and a high degree of diversity between more publicly and more privately-oriented models exists, a number of countries like Latvia, Poland, Romania and Russia are in a similar competitive position to Ukraine. Here, multiple private bureaus provide their services alongside a public credit register.

Furthermore, another interesting finding is provided in the EBRD survey mentioned above. A clear positive relationship between the performance (measured in "total legal efficiency") of the credit reporting system and the level of private sector involvement (in terms of ownership, i.e. private credit bureaus) can be drawn, as the following figure shows:

Figure 1

Transition countries: Main institutional form of credit reporting systems (2011)



BOS – Bosnia and Herzegovina, BUL – Bulgaria, CRO – Croatia, GEO – Georgia, FYR – Macedonia, HUN – Hungary, KAZ – Kazakhstan, KGZ – Kyrgyz Republic, MON – Mongolia, LAT – Latvia, POL – Poland, ROM – Romania, RUS – Russia, TUR – Turkey, SER – Serbia (excluding Kosovo), SVK - Slovakia

Source: EBRD (2012)

Notes: Scale for private sector involvement ranges from 1 (only public registry) to 5 (private provision in a competitive environment). Legal efficiency encompasses different criteria that are grouped under two headings: basic legal function and the maximization of economic benefits

Even though this result is not fully supported by all countries (i.e. Croatia, Georgia and Latvia perform rather poorly, despite their private bureaus) this is indeed an interesting result, taking into account the often controversial discussion about the most appropriate model of operation.

Assessment: As already highlighted in our previous research on this issue, Ukraine's competitive environment with multiple private bureaus is in principle the right development model. According to recent research, a high degree of private sector involvement as in Ukraine is a fundamentally healthy market structure for the credit reporting system.

2.2 Existing Problems

A credit bureau market with a high degree of competition between private bureaus should ideally lead to the provision of accurate and cost-effective credit reports and related products/services for the users of the system. However, this market structure may also bring certain problems with it, as the situation in Ukraine shows. In the

following, we focus on two main problems, the fragmentation of the information and the lack of data.

- The fragmentation of information stored in the credit reporting system means that even though there may be a lot of information in the credit bureaus sector, this information is kept by different credit bureaus and thus not easily accessible by a user. In the context of Ukraine, where the subject's credit history is often split over multiple sources, this is indeed a key problem. This was already discussed in our previous report "Improving the Framework of Credit Bureaus' Operations: Key Recommendations" (chapter 4). As a result of this fragmentation, users (banks) have to make multiple requests regarding the same data subject, which is expensive and time consuming. Furthermore, the data delivery standards are usually not unified, i.e. the bank has to make further adjustments of the credit reports delivered in order to use them in their internal loan approval systems.
- Apart from the intra-sectoral fragmentation of information, which is problematic, a vast amount of potentially useful information stays outside the credit bureaus in Ukraine. This lack of data relates to two main problems: First, credit bureaus have no or only limited access to state databases and public records, which include very important pieces of information. Second, data providers outside the financial industry like telecom companies or utilities do not contribute their useful data to the system.

Assessment: While we support the privately-dominated credit bureau market infrastructure in Ukraine, we see two main problems for a better sector performance. First, the fragmentation of credit information within the credit reporting system, and second the lack of potentially useful data contributions from state and non-bank private sources.

2.3 Possible Solutions

Having established the two main impediments for fully utilizing the potential of the credit reporting sector in Ukraine, the natural question is what can be done about them. As we stated before, the market structure is in principle healthy, and should not be changed. Thus, any changes should be implemented within the current market structure. An important role in this regard could and should play an increased level of cooperation between the private bureaus. Of course, as credit bureaus first and foremost compete with each other for business, there are natural limits to such cooperation. However, competition issues should not exclude certain cooperation activities within some well-defined limits, as long as there are in the interest of most participants[2].

How could such cooperation initiatives targeted at overcoming information fragmentation and lack of data look like in practice? While there are very different models possible,

[2] Theoretical considerations suggest that in credit reporting markets, due to economies of scale and network externalities, a tendency towards an oligopolical market structure with only a few dominant players exist. This is supported by empirical evidence in mature markets, where after a certain concentration process usually only 2-3 bureaus dominate the market.

which furthermore may overlap to some extent, a number of basic models can be distinguished:

- Setting-up of an Industry Association of Credit Bureaus: As in many other industries and sectors, an effective industry association can deliver important benefits to its members, both in terms of improving the regulatory and supervisory framework (lobbying), and by informing the public about the benefits of credit reporting (public education).
- Establishment of a Code of Conduct: Such a code includes well-established and recognized fundamental principles observed by the majority of internationally operating credit bureaus. This in turn increases the trust in the system of credit reporting, which is currently rather low in Ukraine.
- Sharing of Information: In countries where more than one entity (public or private) is active in the credit reporting system, the issue of sharing (fragmented) information becomes topical. Indeed, in a number of countries with multiple bureaus, information sharing is already a reality (e.g. in Bosnia and Herzegovina, Poland and Russia), whereas in other countries this form of cooperation is so far not used (EBRD, 2012).

These basic models target to different degrees the problems identified previously. However, it has to be stressed once more that these cooperation initiatives are just possible examples within a relatively broad continuum of possible solutions. Furthermore, there exist interlinkages between them, which should be taken into account. To give an example, an industry association may be an important platform to launch subsequent initiatives, like a Code of Conduct. Similarly, the establishment of such a code among the major players might be a first step towards the foundation of an institutional industry association. The identification of the concrete form of cooperation will thus be an important aspect in the following chapter.

Assessment: The main problems in Ukraine, the fragmentation of credit information and the lack of potentially useful data contributions, could be overcome by better cooperation between the credit bureaus operating in the country. A number of possible modes of cooperation, ranging from the establishment of an industry association and related activities, up to an improved sharing of information can play an important role in this regard.

3. Facilitating Cooperation between Credit Bureaus

Having identified the main problems for a better functioning of the private credit bureau sector in Ukraine, the question is how to increase cooperation between the market players. In the following section, we will analyse and assess respective plans that are currently under discussion in Ukraine. Afterwards, we will propose a number of additional steps and recommendations that could help to improve the situation. For each individual plan/proposal, we ask if and to what extent this particular measure could help to overcome the problems analysed in the previous chapter. Thus, we establish a tight link between previously identified problems and their solutions.

3.1 Assessment of Current Plans

Among stakeholders in Ukraine, there are currently two main plans under active discussion: The foundation of an industry association of credit bureaus, and the development of a new mechanism of data exchange between participating bureaus.

a) Foundation of an Industry Association of Credit Bureaus

Currently, there is no industry association of credit bureaus present in Ukraine, even though the "Law on Credit Bureaus"[3] allows explicitly for the establishment of such an association in order to protect the interests of its members.

At the time of writing, 5 out of the 7 licenced credit bureaus support current plans to found such an industry association. The main goals of such an association would be advocacy (lobbying) and informing the public about credit reporting (public education). It should further ensure the confidentiality, accuracy, and adequate processing of data in accordance with international best practice, thereby increasing transparency and confidence in credit reporting.

An industry association would be able to communicate officially with the regulator/supervisor and other official bodies on different issues, including an improved access to state databases. This would be a major improvement versus the status quo, and should be in the interest of all participating bureaus. Furthermore, an association would form an important link to international partners, including international financial institutions as providers of technical assistance.

In both developed and emerging markets, such industry associations play and important role in the further development of the credit reporting infrastructure, as Box 1 shows in more detail.

[3] Law No. 2704-IV "On Organization of the Formation and Circulation of Credit Histories", adopted on 23 June 2005 and effective from 29 January 2006.

Box 1

Credit bureau industry associations – Selected examples

USA

The Consumer Data Industry Association (CDIA) is the industry association for various consumer reporting companies. It represents currently around 200 consumer data companies, among them the market leaders Equifax, Experian and TransUnion. CDIA works with a wide range of stakeholders, among them state legislative and regulatory bodies, media, banks, and others on a wide range of relevant issues. Furthermore, CDIA co-sponsors a biennial international conference on credit reporting jointly with the European Association of Consumer Credit Information Suppliers (ACCIS).

http://www.cdiaonline.org

Europe

Established in 1990, the European Association of Consumer Credit Information Suppliers (ACCIS) is an international non-profit association. It currently brings together 37 consumer credit bureaus in 27 European countries and 4 associate members from other continents. The main role of the association consists in the advocacy of members' interests' vis-à-vis government bodies, the public and other stakeholders, and to inform its members about matters of relevance to them.

http://www.accis.eu/

South Africa

The Credit Bureau Association (CBA) of South Africa unites 5 out of the 11 licensed credit bureaus in the country. Its main mandate is to provide a framework for a sustainable and well-functioning credit reporting system, which helps to promote effective management of credit risk. This is done by facilitating fair and equitable practices within the industry in order to promote transparency, accountability, high quality reporting and sound business practices. The CBA helps to ensure the confidentiality, accuracy, relevancy, and proper utilization of data in accordance with internationally recognized standards. In order to do so, the association monitors the operations of its members and ensures that they abide by its Code of Conduct.

http://www.cba.co.za/

Sources: Association's own information resources

In Ukraine, a first step towards the establishment of an industry association would be the formation of an unincorporated association (as opposed to an incorporated association, which is a legal entity). Since the beginning of 2013, the new law on public associations is in force, which allows for a relatively quick and straightforward establishment. Specifically, a statute and officers are not required for an unincorporated association. To form an unincorporated association, a founding meeting must be conducted, and within 60 days the Ministry of Justice must be notified by filing/mailing a form with attached:

- minutes of the founding meeting, including a number of requisite elements with notarized signatures of participants;
- information on founders of the association;
- information on person/persons authorized to represent association (if any).

The Ministry of Justice must approve the notification if the legal requirements are satisfied, and register the association within 5 days.

How could the association help to overcome the problems identified? Since an association would have much more leverage in negotiations with state bodies regarding access to state databases than individual bureaus, we believe that access to additional data would be the main impact in the short term. It may also help to improve the situation with data fragmentation, but this depends on the concrete activities of the association.

Assessment: We fully support current plans to set up an industry association by the major credit bureaus, as this will help to improve access to data, among other issues, and will take cooperation to a new level. The specific form of an unincorporated association should be used in the beginning, as this is a quick and rather un-bureaucratic procedure.

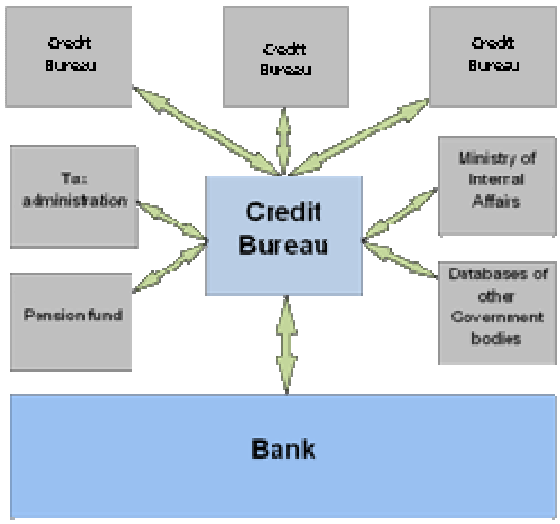
b) Improvement of Data Exchange

Data fragmentation that leads to expensive and time-consuming procedures for users is identified by virtually all major stakeholders as an impediment for a further development of the credit reporting sector. This insight shaped a recent initiative by users of credit bureaus (banks) on how to improve data exchange between private credit bureaus, so that users do not have to work with all bureaus in parallel. As a consequence of these plans, the "One point of Access" (OPA) mechanism was developed by the working group on credit bureaus of the "Forum for Leading International Financial Institutions" (FLIFI). The following box gives more detailed information on how the concept is supposed to work in practice.

Box 2

Proposed "One point of Access" model of data exchange

The concept "One point of access" assumes an expansion of the access to credit histories by users such as banks through a single credit bureau. The bureau in question, after having received a request by a user (bank), will check not only its own database, but also send automatically a request to another bureau, based on the cooperation agreement on "One point of access". The main advantages of this concept are according to its developers the relatively quick introduction, the presence of a legal framework and relatively cheap requirements in terms of material and human resources. The proposed scheme can be displayed as follows:



Source: FLIFI Working Group "On the development of Credit Histories Bureau in Ukraine", 2011

So far, the concept has been discussed extensively among stakeholders since 2011, in particular among users and credit bureaus, but its concrete implementation in form of a pilot project between at least two bureaus has not been achieved so far. While its benefits for the users, and indeed the whole market development seem obvious, the (competing) bureaus seem not eager to engage in such a wide-ranging cooperation initiative at this particular point in time. Thus, for the near future, other mechanisms of cooperation regarding data exchange should be actively developed and promoted.

Our view: While the "One point of Access" data exchange concept is in principle an interesting approach to overcome data fragmentation, market players seem not ready to adopt it. Thus, other mechanisms in terms of improved cooperation need to be identified.

3.2 Extending Cooperation: Further Recommendations

The cooperation initiatives mentioned in the last section are very much welcome, as they demonstrate clearly that stakeholders have a clear picture of the deficiencies of the credit reporting system, and show willingness to solve them. However, these measures alone will not be sufficient to overcome data fragmentation and lack of data in the system. Below, we provide a number of additional recommendations that may contribute to a further development of the credit bureau sector towards a more efficient sharing of information.

a) Development of a "Code of Conduct"

A "Code of Conduct" includes well-established and recognized fundamental principles according to best international practices. This in turn could increase the trust in the system of credit reporting, which is currently rather low in Ukraine. The main purpose of the introduction of such a code is thus to require the credits bureaus in Ukraine to adopt adequate operating procedures with respect to the confidentiality, accuracy, and proper processing of data in accordance with the requirements of the code. Thus, consumer protection issues are very important in this regard, especially a clause not to use information obtained from informal/illegal sources, which is currently rather problematic in Ukraine.

The planned new industry association could function as an umbrella for all activities related to the development of such a principle-based Code of Conduct. It would drive the consultation process within the financial industry and consumer protection groups forward, possibly with the help of external consultants. Once it is adopted, the code should be made public, and appropriately monitored and enforced by the association.

Practical examples of such codes can be found in different countries, e.g. in South Africa (Credit Information Industry Code of Conduct by the Credit Bureau Association[4]), Australia (Code of Conduct by Australia's Credit Reporting Industry[5]) as well as in Italy and Hong Kong, among others.

[4] http://www.cba.co.za/cba/downloads/CBA%20-%20Code%20of%20Conduct.pdf
[5] www.privacy.gov.au/materials/types/download/9254/6787

How could a Code of Conduct help to overcome the problems identified? This cooperation effort would increase transparency and credibility in the credit reporting system in Ukraine, which would be positive for the whole sector in terms of data completeness and also the quality of data.

Recommendation: A major task for the foreseen new industry association would be the development of a Code of Conduct, which contains well-established and recognized fundamental principles in credit reporting.

b) Development of a Credit Bureau Dashboard

The data fragmentation of the credit reporting system was already mentioned as a major problem, mainly for the user-side (banks). Currently, they lack a transparent and verifiable overview of the whole market, i.e. about the information that is stored in the system.

In order to fill that gap, a first step towards more transparency would be the establishment of a regular (monthly, quarterly) reporting infrastructure on the development of the credit bureau market. A sufficient reporting would include the following items:

- Market share/coverage and vintage of credit histories for each bureau as well as the overall figures,
- Information overlap rate by all bureaus,
- Average hit-rate by queries received from users,
- Structure of the stored information in terms of different products, segments (Individual, SME, Corporate), negative/positive histories.

Apart from the regular reporting, the institution responsible should perform mandatory cross-checks of the information provided, including checks of clients' consent on data transfer. This would almost immediately lead to data quality improvements. At the same time, it would help users to get a better understanding of the market and ultimately lead to a healthy competition among bureaus and a fair pricing of their products. This could also include the market exit of certain bureaus which capture non-relevant information as a result of this competitive process.

Who should be tasked with the implementation of regular reporting? In our view, the planned new industry association would be an ideal platform for such a non-partisan regular reporting, as the bureaus themselves can organise and drive this process forward. These activities should be conducted in close collaboration with the supervisor, who may be interested in the report also for its own supervisory purposes. In case the association is not willing or able to perform the task, the supervisor should take over this responsibility.

Recommendation: A regular reporting process in form of a "credit bureau dashboard" should help to increase transparency and the quality of data. Ultimately, this will contribute to a better understanding of the market by its users and increase competition among bureaus.

c) Increasing Financial Literacy and Better Communication with Individuals

The credit reporting market in Ukraine is still an evolving and rather new feature in the financial market landscape, which implies that information about the advantages of credit reporting for the population is still relatively scarce. Furthermore, due to the low transparency of certain players, the general trust in the system is low, which can be seen as a negative external effect. To increase the financial literacy of the local population particularly in terms of the credit history market, an industry association could help to increase gradually the trust of the population in the system, which should ultimately benefit the whole sector in terms of data quality and data completeness.

An independent and non-partisan industry association would be an ideal platform to increase the financial literacy of the population by launching information products, e.g. brochures and leaflets, among others, but also by using mass media and other channels (e.g. public seminars) to increase the public outreach.

Another area where the association might play an important role relates to the communication between the subjects (i.e. individuals) of credit history and the credit bureaus. By law, each person has the right to request her/his credit report and notify the bureau about possible errors in the report. In practice, this communication is rare and rather complicated, thus simpler communication forms should be established in the market (e.g. via e-mail/phone registration). This is an area where the association could set generally binding standards for all of its members; banks could play an additional role in this respect as well.

Recommendation: Increasing financial literacy of the population with respect to credit reporting and its benefits for an improved access to finance should be a major focus of the new industry association.

d) Achieving new Dimensions of Cooperation between Bureaus

In the previous section, the currently discussed data exchange mechanism "One point of Access" (OPA) was explained. This concept is meant to overcome data fragmentation, which implies that users have to engage with several bureaus at the same time. Apart from the aspect of additional costs when addressing different bureaus, it implies that credit reports delivered by the bureaus cannot be used directly within the bank's application processing due to different data formats. Banks thus need to spend additional resources and/or time to process the different information they obtain from the bureaus.

In addition to the OPA concept, which implies that bureaus exchange (their own) data with their competitors, and thus may show less willingness to engage in such an exchange, there are other, less sensitive mechanisms towards other cooperation initiatives between bureaus. In light of the problems regarding spending extra money and time when faced with data-fragmentation for the user-side, the right answer would be a bureau-driven move towards more standardisation and harmonisation of the data exchange between bureau and user. A certain level of standardisation and harmonisation agreed upon by the bureaus would facilitate the information exchange and data transfer in terms of resources and time spent. Technically, this could be implemented by the development of a joint bureau "connector" with a flexible interface that allows for an easy data transfer between bureau and bank. This will likely increase the interest and thus

also the number of total users. Each bureau will continue to receive its revenue corresponding to their respective "hit" rate.

Extending this approach further, bureaus could also chose to cooperate in certain areas of product development like credit scoring. A joint bureau score development could be a cost-efficient way to split development costs, which would benefit also the final user.

It should be stressed, however, that the right timing for such initiatives is crucial. In the current situation, where bureaus are rapidly expanding their databases, there is probably not sufficient interest from their side for such a concept. This may, however, change in the medium term, when their databases are more mature, and competitive forces become stronger.

Recommendation: In the medium-term, cooperation initiatives like achieving a higher degree of standardisation and harmonisation of the data exchange process look promising in terms of overcoming data fragmentation.

4. Outlook

It is clear that credit reporting in Ukraine is far from being perfect. But this assessment should not distract us from significant achievements in the sector. First, Ukraine has a good and modern legislation concerning credit bureaus. Second, the country has a healthy and competitive market structure, with several private-owned bureaus competing for clients. Third, a majority of the private credit bureaus act with much responsibility and are ready to invest time and money in improving the current situation.

Thus, the country fulfils the necessary preconditions for improving the performance of its credit bureaus' sector. The crucial point for increasing performance is the cooperation between credit bureaus. In our view, the establishment of an industry association would be a strategic step forward, which would then contribute to further progress. While the association should try to include as many credit bureaus as possible, it is not compulsory that all current bureaus participate. In fact, a limited number of reform-minded members might facilitate the work of the association and preclude the vetoing of important initiatives by bureaus with a questionable business model. Thus, the association might contribute to a consolidation and an improvement of standards at the same time.

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