

German Advisory Group

Institute for Economic Research and Policy Consulting

Policy Paper Series [PP/04/2012]

Improving the Framework of Credit Bureaus' Operations: Key Recommendations

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Berlin/Kyiv, May 2012

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Improving the Framework of Credit Bureaus' Operations: Key Recommendations

Executive Summary

Credit bureaus are an essential part of the financial infrastructure of a country. By pooling and exchanging information about borrowers, banks can improve their risk management and lending decisions. In such a way, the cost of borrowing can be reduced and the access to finance of previously underserved borrowers like SMEs increased, a fact that is supported by wide empirical evidence. Consequently, credit bureaus are not just important for banks, but also for the real economy and the society.

Ukraine has several credit bureaus, but the sector as a whole is not working properly yet. In this report we identify the main causes for this and put forward recommendations to improve the situation. One major problem relates to the regulation and supervision of credit bureaus, which lies in the responsibility of the National Commission for Regulation of Financial Services Market. Unfortunately, the commission lacks the necessary institutional capacities for this task, with negative implications for the sector. Consequently, we recommend shifting this important task to the National Bank of Ukraine (NBU), which has a wide knowledge about the banking sector due to its role as banking supervisor. Ukraine's credit bureau sector should be based on private bureaus, and within a strong regulatory and supervisory framework guaranteed by competent state authorities. This is our vision of the future.

A further key problem relates to the sources of data for credit bureaus. In many cases, banks either do not report credit information at all, or they restrict their reporting to "black" information. Furthermore, the access of credit bureaus to public registries is far from optimal, especially to those under the Ministry of Justice. Last, data at the level of individual credit bureaus is highly fragmented, in part due to a lack of cooperation between credit bureaus. In principle, there are two ways for the banking regulator to try to improve the situation: mandatory schemes or regulatory incentives. For example, the regulator can mandate that information has to be delivered to credit bureaus or it can increase the level of required reserves for loans, for which no information has been sent to credit bureaus. Based on international experience and taking into account Ukrainian reality, we recommend to base policy on incentives rather than on mandatory schemes.

Also the issue of data protection is crucial. Here it is essential to strike a balance between the objectives of efficient information sharing and of ensuring and protecting the informational privacy of individuals. Besides, if individuals do not trust the system, then it is highly unlikely that the system will work properly.

Improving the framework for credit bureaus is thus a joint task for all stakeholders in the public and private sector, with clearly defined roles and responsibilities. This will contribute to a more stable banking sector, but it will also improve the access to finance of SMEs and individuals, thus contributing to the growth of the banking sector. Consequently, implementing the recommended measures will lead to more stability while ensuring sustainable growth, two aspects which often are not easy to combine. Therefore, progress in this important field is exactly what the banking sector in Ukraine needs after the massive shock during the international financial crisis in 2008/2009.

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NOTE: This Policy Paper has been financed by the German Federal Ministry of Finance under the TRANSFORM programme and its successor.

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1. Introduction

Ukraine's economy, and in particular its financial sector have been hit exceptionally hard by the global financial crisis in 2008/09. The country has so far not fully recovered from the output losses during the crisis, when real GDP posted a record 15% decline in 2009. The banking sector suffered equally hard during the crisis, with massive liquidity and solvency problems at a number of institutions. The state, supported by the international donor community had to bail-out a number of systemic institutions during that process in order to prevent an outright collapse of the system.

In line with recent trends and developments in the real economy, a post-crisis recovery in the financial sector in Ukraine is currently observable. Even though this process is still fragile, and subject to many external and internal risk factors, it signals that the worst is likely over. At the same time, the current recovery phase gives the opportunity to focus on drawing important long-term lessons from the crisis. While the last crisis was mainly caused by negative external shocks, existing structural problems in the banking sector made Ukraine vulnerable and exuberated its negative impacts on its economy.

The overall objective for all stakeholders concerned (regulator, banks, clients) must be to make bank lending in Ukraine a more reliable process than previously, which strikes the right balance between the sector's growth and stability1. Among the many structural and institutional reform aspects that are of interest here, a key component is a fully functioning credit reporting system. The main purpose of credit bureaus is to stimulate comprehensive information collection and sharing, in order to help lenders make better decisions. Credit bureaus are thus an essential part of the general credit infrastructure; if they do not function properly, access to finance is often constrained, i.e. severe financial constraints hinder otherwise creditworthy firms and individuals from obtaining much-needed finance. This is a problem especially for small and medium sized companies (SMEs), which are an important factor for economic growth and job creation. The economic benefits of credit bureaus thus extent far beyond the direct benefits for banks. The associated positive impact on Ukraine's economy and society is even more important, potentially creating a win-win situation among lenders, borrowers, and society as a whole.

This paper contributes to the ongoing discussion on improving the credit bureau system in Ukraine. It is structured as follows: In chapter two, we show the important economic functions of credit bureaus. There is wide empirical evidence that such bureaus can facilitate access to credit as they help lenders make better decisions. The remaining chapters three to five are devoted to the concrete situation in Ukraine. Here, we identify the main problems in credit bureaus' operations in the country, and provide policy recommendations on how to improve them.

[1] For a detailed analysis of Ukraine's banking sector and some policy recommendations, see Kirchner et al. (2011).

2. Economic Functions of Credit Bureaus

2.1 Definition and Concepts

Each borrower in financial markets leaves a trail of important information behind his transactions. This concerns e.g. his past payment behavior, including the full and timely payment of existing financial obligations, but also the sum of all loans taken from different sources as well as information stored in public databases. Credit bureaus collect, process, maintain and analyse this information from a variety of sources, and make it available upon request to their subscribers in different forms, among them banks and non-bank financial institutions as well as supervisory authorities. In this process, they reduce information asymmetries, and allow lenders to more accurately assess credit risks and thus improve the quality of their portfolios. Credit bureaus can thus be seen as a driving force in information transfer and exchange, which increases transparency and can be considered as an important element of modern banking. Financial markets around the globe increasingly understand the value of sharing data.

Information for both individuals and entrepreneurs (consumers and retail loans, as well as mortgages) and corporate entities (mainly SMEs) are usually collected by credit bureaus. While lenders rely usually on other mechanisms to assess the creditworthiness of bigger firms and corporations, their options regarding individuals and SMEs are much more limited. The absence of comprehensive and reliable information on these groups implies that the lending risk for banks is exceptionally high, resulting in a constrained access to finance for "good borrowers" among these groups.

2.2 Economic advantages

Economic theory suggests a number of important economic benefits from the existence of a system of fully operational credit bureaus. The four key advantages of sharing information are the following[2]:

1. *Better assessment of default risk:* The information supplied by bureaus in their credit reports/histories helps lender to assess the default risk/creditworthiness of the borrower much better. This eases adverse selection problems; banks can target and price loans much better, concentrate their marketing efforts on "good" clients, including developing new products for them.
2. *Reduction of informational rents:* By reducing the informational rents that a bank could possibly extract from a certain borrower, information pooling by bureaus leads to a more competitive loan pricing.
3. *Enforcement of borrower discipline:* Since each borrower knows that his reputation with all potential lenders is negatively affected if he defaults, this reduces moral hazard effects.

[2] See Japelli/Pagano (2000) for a more detailed discussion.

4. *Elimination of incentives to overborrow:* Since a well-organised system discloses the overall indebtness of a borrower, this eliminates incentives to overborrow from multiple lenders.

In practice, the advantages of credit bureaus discussed above create a win-win situation for all participants, namely:

1. *Lenders (banks):* Better lending decisions and risk management at individual banks lead to a better performance at the individual bank level, with lower losses from defaulted loans.
2. *Borrowers (individuals, SMEs):* The mentioned decline in loss rates will also benefit "good" clients, which enjoy better access to credits and lower interest rates as a result.
3. *The financial sector:* A more sustainable lending process strengthens the financial and banking sector, bolsters confidence and supports the recovery of the financial system after the crisis.
4. *The national economy, or more general, society:* Important socio-economic effects are associated with a strengthened banking sector and improved credit allocation. This directly increases economic stability, leads to higher economic growth and a more dynamic economy.

2.3 Specific Issues in Emerging Markets

In the context of emerging markets and economies in transition, there are additional economic arguments for the activities of credit bureaus. Such countries are often characterized by a weak protection of creditor rights (e.g. in terms of enforcing repayment, getting access to collateral or taking control of the defaulted company) as well as having a lower (accounting) transparency.

These specific features increase screening costs for banks and aggravate information asymmetries, in particular for loans to individuals and SMEs. Often, the loan volumes in question do not justify a targeted credit risk analysis, which would be rather expensive. Against this background, the information sharing process associated with credit bureaus is even more valuable than in developed markets, as it at least partially substitutes for weak creditor protection through the legal system.

An additional argument for credit bureaus in emerging markets is that they can also facilitate the transition from a mainly collateral-based lending system to a modern cash-flow (information-) based system.

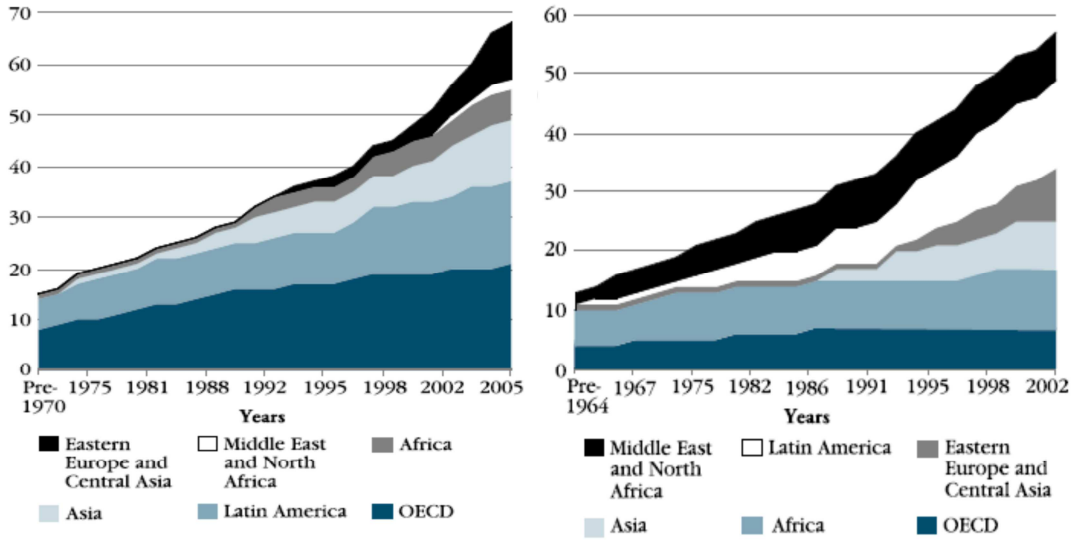
2.4 Empirical Evidence

The number of countries which established credit reporting systems, either in private (i.e. credit bureaus) or public (credit registry) ownership[3] has grown spectacularly over the last 25 years, as the following figure 1 shows.

[3] We will return to the question of ownership in the next chapter.

Figure 1

Countries with Private Credit Bureaus (left) and Public Credit Registries (right)



Source: IFC (2006)

Note: Please note the different axis dimensions on the left and the right side figure.

Parallel to this explosive growth, there is a wide and growing empirical literature on the effects of information sharing in banking in general, and the activities of credit bureaus in particular. This literature usually tries to identify links between the operations of credit bureaus on credit penetration, credit growth (access to credit), default rates (NPLs), and interest rates, often distinguishing between different borrower categories (individuals, SMEs). Both developed and emerging markets are the subject of the literature. We try to give a short overview of the main results that can be taken from this growing literature below.

Impact on credit penetration:

Japelli/Pagano (1999) are among the first pioneers in the economic literature to identify a link between information sharing and the breadth of credit markets in a cross-country study. Bank lending to the private sector (measured in relation to the gross national product) is higher in countries where more active information sharing is practiced. Credit sharing is thus an important determinant for credit availability. These results are supported by Djankov et a. (2005), which analysed a sample of 129 countries. The introduction of private or public information sharing (in form of credit bureaus or a public credit registry) raised the private credit to GDP ratio in a statistically significant and quantitatively important manner. Specifically, after the introduction of information sharing mechanisms, the private-credit-to-GDP ratio increases by 7 - 8 percentage points over a 5 year horizon. Equally important, the more comprehensive the information is that is distributed, the higher the impact; a finding that is also reported by other authors.

Impact on interest rates and defaults:

The previously mentioned study by Japelli/Pagano (1999) also found that information sharing leads to lower loan delinquencies and defaults and helps to decrease interest

rates for borrowers. Turner et al. (2008) reported similar results of lower losses and lower interest rates.

A joint Inter-American Development Bank/World Bank survey in 2002, covering banks in Latin America that lent primarily to consumers and SMEs, found that using information sharing mechanisms lowered the rate of non-performance in their loan portfolios as compared to banks which did not use information sharing.

Impact on particular borrower groups:

The impact of information sharing on different borrower groups is another focus of the empirical literature. Love/Mylenko (2003) analysed a sample of 5,000 firms in 51 countries and found that the introduction of information sharing mechanisms caused the share of SMEs reporting financing constraints to drop from 49% to 27%. The probability of granting a loan to SMEs increased from 28 to 40%.

Turner/Vargese (2007) and Turner et al. (2008) found that an increase in the coverage of credit bureaus helps especially previously financially underserved groups of the population. As a result, the associated increase in lending leads to a more equal income distribution.

Impact on emerging markets:

Brown et al. (2009) analysed a sample of 5,717 firms in 24 transition countries and confirmed that information sharing leads to better access to credits and lower costs of borrowing. Smaller firms profited relatively more than bigger ones from these developments.

Information sharing thus seems to be especially important in countries with weaker legal environments, and thus weaker creditor protection. This result is supported by Djankov et al. (2005), where improvements in information sharing mechanisms are especially relevant for lending in less developed countries. This effect could not be replicated in developed markets, where other determinants seem more important in explaining lending.

2.5 Credit Bureaus in Ukraine: The Road Ahead

From extensive talks with different stakeholders[4] the general conclusion can be drawn that the current system of information sharing in Ukraine is not working properly, as many problems are being reported[5]. Thus, the important functions of a credit reporting system are not being fulfilled from an economic and social point of view. This is not surprising, taking into account the still relatively new concept, and the economic transition context. Indeed, similar problems are reported from other emerging markets

[4] This concerns banks, credit bureaus, the regulator, the National Bank, non-bank financial institutions and international financial institutions, among others.

[5] In order to assess the performance of credit bureaus in Ukraine, we rely mainly on the results of our frequent conversations with all relevant stakeholders. It is extremely difficult to measure the performance of the bureaus with objective indicators only, as ideally a wide number of both qualitative and quantitative factors need to be taken into account, for which often no information are publicly available.

and transition countries, where different stakeholders resist the concept of information sharing due to different reasons.

In the following chapters, we identify areas where problems were frequently reported, and provide recommendations on how to improve the situation. This relates to the fundamental role of the state in the credit reporting landscape (chapter 3), to data issues (chapter 4) as well as ensuring a high degree of consumer protection (chapter 5). Even though the international credit reporting landscape is extremely diverse and complex, certain international best practices can offer some important insights in this respect.

3. The Fundamental Role of the State in Information Sharing

3.1 Regulation and Supervision

Until 2009, credit bureaus in Ukraine were licensed, regulated and supervised by the Ministry of Justice. On 4 March 2009, with the passing of the Law "On the Introduction of Changes to the Law "On the Organization of the Formation and Circulation of Credit Histories"", the Ukrainian Parliament transferred the functions of licensing, regulation and supervision of the activities of credit bureaus to the State Commission for Regulation of Financial Services Markets. The commission was liquidated in 2011 by Presidential Decree #1069 and at the same time Presidential Decree #1070 established the National Commission for Regulation of Financial Services Market. The commission fulfils the same tasks as before, but is now subordinated to the President, not the Cabinet of Ministers, as the predecessor[6]. The associated reorganisation will take time, some sources indication a timeframe of up to one year.

There is wide agreement among stakeholders that the current licensing, regulation and supervision framework is weak for several reasons, and has contributed to the low performance of credit bureaus active in Ukraine. Limited institutional capacity in the commission, which is currently in the process or reorganization, is the most frequent reason quoted. This has led as a result to a situation where serious questions regarding data security, integrity and transparency have arisen, with negative implications for the credibility and trust of the whole system. Specifically, among currently licensed bureaus there seem to be a number of institutions that cannot be considered "standard" bureaus, which collect their data from doubtful sources, and thus discredit the whole sector. The problems observable in private credit bureaus operations in Ukraine seem to us more rooted in these deficiencies in licensing and supervision, i.e. in regulatory failure, rather than in a market failure.

In many countries, a data protection authority is responsible for the oversight over credit bureaus. However, the data protection service in Ukraine is still in its infancy and it is struggling to fulfil its core responsibilities that include registration of databases with personal data[7]. Thus, the most sensible solution would be to task the National Bank of

[6] This was already done in 2010, when the subordination to the Cabinet of Ministers (a result of constitutional changes in 2004) was declared invalid.

[7] More information on this can be found in chapter 5.1.

Ukraine, which oversees the banking sector, with the oversight of credit bureaus. This institution, which has a wide experience and professional and qualified staff, would be the natural choice for such a change towards strong regulation and supervision.

It goes without saying that licences should only be awarded to qualified credit bureaus which meet the highest international standards in terms of information sharing. Turner et al. (2009) list a number of areas which are of crucial importance for a credible system:

- Data quality
- Data security
- Transparency
- Data integrity
- Consumer dispute resolution

In addition to these objectives, which the regulator should keep in mind in its work, there are many more that have been extensively discussed in this report: Prevent data fragmentation, and ensure full and comprehensive reporting. All this needs to be implemented in a competition-neutral way, which does not create distortions and does not favour particular institutions. To ensure a level playing field on which a number of private institutions compete on price, data quality and other value-added services would be optimal from an economic and social point of view.

Recommendation 1: Regulatory failure, rather than market failure is the key reason for the relatively low performance of credit reporting so far. A fundamental shift in the licensing, regulation and supervision framework is thus needed, as the current approach failed to a large extent. The National Bank of Ukraine should take over regulation and supervision and ensure a level playing field for private bureaus.

3.2 Market Structure: Private Credit Bureaus vs. Public Credit Register

In credit reporting systems, two major types of institutions can be normally distinguished: Private credit bureaus and public credit registries. In the following, we will analyse both institutions in more detail.

Private credit bureau (PCB)

Private credit bureaus are voluntary data exchange institutions, which compete with each other in the credit information business. Most bureaus operate for profit, but also some non-profit bureaus can be found. In Europe, a recent industry survey found that 83% of the European credit bureaus work for profit (Rothemund/Gerhardt, 2011). In general, two forms can be distinguished further: Bureaus owned by banks or bank associations ("non-neutral"), and bureaus not affiliated with banks ("neutral"). While bank-owned bureaus are usually an important starting point to establish a private credit bureau

system, such bureaus may not be optimal for reasons related to competition, not just in data exchange, but also in the banking market[8].

The dominant profit-orientation of private credit bureaus has two important implications. First, they tend to collect credit information as comprehensive and detailed as possible, in order to deliver as much information as possible to their clients (usually, but not exclusively banks). This is particularly true for information on consumer and SME loans, which are usually ignored by public credit registries due to their small quantitative sizes. Also, the data sources that deliver information to credit bureaus are not limited to banks, but can include also non-bank financial institutions (e.g. leasing and microfinance institutions), as well as non-financial companies like telecoms and utilities. A second important implication is that private bureaus that compete fiercely for business are constantly in the process of introducing new products and services to their clients, as well as to improve their cost efficiency, in order to stay ahead of competition. The development of new products and services (e.g. credit scoring, consulting services, portfolio monitoring, fraud detection, etc.) is a permanent objective for such institutions.

In Ukraine, credit bureaus are still relatively new institutions in the financial infrastructure of the country. After a comprehensive legal framework for their operations was established in 2005, the first bureaus received their licenses in 2007. Currently, there are 7 credit bureaus operating in Ukraine[9], even though not all licensed bureaus can be considered "standard" bureaus that operate according to international best practice [10] . Despite the shortcomings mentioned above in terms of operational performance, there is some empirical evidence that information sharing through private credit bureaus led to an increase in bank lending in Ukraine in the past. Furthermore, the more credit bureaus a bank collaborates with, the higher is the volume of credit expansion. A bank-level study by Grajzl/Laptieva (2011) reports such findings, which are robust through a variety of different specifications and estimation techniques.

Public credit registry (PCR)

A public credit registry is a database created by public authorities and usually managed by the central bank (bank supervisor). It contains credit information, which is compulsory delivered by certain financial institutions, and which get access to this database in return. Usually, there is wide banking data coverage (i.e. all institutions regulated by central bank), but information from other institutions (non-bank financial institutions, telecoms, utilities, etc.) is not included. The purpose of public credit registries is mainly defined by bank regulation and supervision motives, and by ensuring financial stability. Therefore, in most cases there is a threshold size for loan reporting, which excludes smaller loans to individuals and SMEs.

In Ukraine, a „Common Information System" listing delinquent borrowers exists since October 2001, and is operated by the banking supervision department of the National

[8] This is an issue observed in a number of countries, where bank-owned bureaus impeded access to information sharing, with negative implications for banking competition.

[9] For an overview, see Kirchner et al. (2010).

[10] We will analyses this issue in more detail in the following chapters.

Bank of Ukraine. While participation is officially voluntarily (although recommended), most banks report their credit information. The loan threshold size is UAH 10,000. However, in terms of usage a number of banks remarked that the system is in its current form not user friendly, and thus has a relatively small benefit for their operations[11]. It provides no real online access (only email), and there are no clear and transparent database update rules. The low interest from the side of banks is matched by the low interest from the side of the National Bank to improve the system. It is therefore not a surprise that the empirical literature fails to identify an effect of information sharing through the public credit registry on bank credit extension in Ukraine. Grajzl/Laptieva (2011) reported that no statistically significant effects could be found in their analysis.

PCBs versus PCRs: Implications for Ukraine

In Ukraine, there is an on-going discussion about the "right" market structure of the credit reporting system. Several stakeholders point out that private bureaus have failed to fulfil their functions, and thus propose a stronger involvement of the state in the market, possibly building on the existing public registry. We remain sceptical of such an approach, as in our view the main fault of the current system has been inadequate regulation, rather than a wrong market structure. The problematic and somewhat disappointing performance of the public registry is another argument in support of our view.

Internationally, the market structure in credit reporting systems regarding private credit bureaus and public credit registries is rather fragmented. While there are a few countries that rely only on private bureaus (e.g. the US, the UK and Canada, among others), and a few other countries that have only a public registry (e.g. France), most countries have a mixed market structure that includes both private bureaus and a public registry, with very different degrees in terms of practical implementation and coverage. A strong determinant for the emergence of a predominantly private or public system seems to be the legal system of the country, i.e. if it is based on English common law versus French civil law.

Taking into account the many differences between private credit bureaus and public credit registries, it is obvious that they are not mutually exclusive, but rather complementary in nature. Indeed, many possibilities of interaction exist, which help to improve the credit reporting system in general. In some countries, PCRs were created to stimulate competition with (non-neutral) PCBs, which were sometimes perceived to be too close to existing banks, and which resulted in a difficult entry for new banks in the banking market. In other countries, PCRs deliver their data also to PCBs, which make use of this information in their credit reports.

Recommendation 2: A public credit registry should not be seen as a substitute for private credit bureaus, but rather as an important complement, which opens new ways of interaction. Private bureaus must remain the main pillar of the credit reporting system in Ukraine.

[11] See also Grajzl/Laptieva (2011) on this.

4. Improving Data Submission and Information Exchange

4.1 Banks and Credit Bureaus

The more information credit bureaus can collect from banks, their main source of data, the more complete are the credit histories of the data subjects they contain in their database. This provides for the most accurate assessment of credit risks and leads to better lending decisions.

Contrary to these obvious benefits in terms of full-fledged and comprehensive information sharing, in practice two main problems exist. First, banks often do not submit data to credit bureaus, with negative implications for their databases. Second, in some cases when banks do report information, they send only negative ("black") information on defaults and arrears, while skipping positive information on regular debt service for fear of losing good clients.

These problems have sparked in many countries around the world a lively discussion on the optimal procedures of data submission. In response to the first problem, the question of mandatory data submission (to at least one or all bureaus) versus voluntarily data submission is a central issue in many countries. The following table 1 shows the existing national differences in data submission in Europe.

Table 1

Voluntary versus required sharing of credit data: European Experience

Country	**Is credit data sharing required by national regulation?**	
	YES	**NO**
Austria		x
Belgium	x	
Czech Republic		x
Germany		x
Denmark		x
Finland		x
Greece	x*	
Croatia		x
Hungary	x	
Iceland		x
Italy		x
Netherlands	x	
Norway		x
Poland		x
Romania		x
Serbia	x	
Russia		x
Sweden		x
Slovenia	x	
Slovakia		x
Spain		x
Turkey		x
Great Britain		x
Total	**6**	**17**

Source: Rothemund, M., Gerhardt, M. (2011). The European Credit Information Landscape. An analysis of a survey of credit bureaus in Europa. Industry Survey. The European Credit Research Institute (ECRI).

*Note: * for bad cheques*

Country experience shows that only in a clear minority of countries data sharing is mandatory (6[12] vs. 17). Furthermore, among the 6 mandatory countries, we find also 3 emerging markets (Hungary, Serbia, and Slovenia), where this instrument might have a temporary character.

But even if data sharing is not mandatory, the banking supervisor can strongly encourage banks to share information with different incentives. A more favourable regulatory treatment for loans (in terms of reserve requirements) where such information is submitted to credit bureaus is an important instrument in this regard. However, it should be noted that in case of mandatory pressure or regulatory incentives to share data, there might be unintended consequences. An extreme form of this can be seen in the creation of "captive" bureaus, where banks – due to legal or regulatory reasons – are encouraged or required to submit data to at least one bureau, and thus some created their own bureau (e.g. Ukraine, Russia). This runs clearly against the objectives of encouraging information sharing, and thus should be prevented as far as possible.

In Ukraine, we favour indeed such an incentive approach over mandatory data sharing. The relevant instrument is Resolution #23 of the National Bank of Ukraine from 25 January 2012, which will be effective from the beginning of 2013 and aims to modernise reserve formation[13]. This resolution requires banks to classify a company with a loan exposure as at most risk category 8 (out of 9 categories, with 9 indicating the least creditworthy category) borrower, if the bank didn't transmit information to a credit bureau. This has direct implications for reserve formation. To give a numerical example: Reserve requirements range between 1% - 6% for a loan to a very creditworthy company (category 1), that is being serviced timely and the data are transmitted to a credit bureau. For the same constellation, but with the only difference being that the data are not transmitted to a bureau, the reserve requirements increase to 7% - 20%. Reserve requirements can increase further in case the loan becomes overdue (up to 100%). Similar requirements are in force for individual borrowers, but here only four risk categories exist. If banks do not transmit data to a credit bureau, the borrower is grouped into the weakest category 4. Reserve requirements are similar to the case with corporate loans. In addition, banks won't be allowed to use portfolio treatment for loans where information is not submitted to a credit bureau, and thus loans must be re-evaluated every 3 months individually. This is a rather strong argument for submitting data to credit bureaus, which is available to all loans under UAH 50,000.

The second problem mentioned above relates to the extent of information supplied to bureaus. Credit risks can be assessed more accurately if the credit history includes both positive and negative information, i.e. there is full-file reporting. In case mandatory reporting is required, this should be full-file, i.e. also including positive information. But also the incentive-related approach to stimulate information sharing must be based on full-file reporting. A better regulatory treatment of loans can only be granted when banks report all available information about a client.

[12] Actually 5, since in Greece it is mandatory only for bad cheques.

[13] Reserve formation is currently governed by Resolution #279, which will expire at end-2012.

Recommendation 3: Banks should be encouraged to provide full-file reporting to bureaus. In this respect, we favour regulatory incentives rather than mandatory data sharing.

4.2 Access to State Databases and Public Records

Apart from information delivered by banks and individuals, there are important additional information stored in different state databases and public records. This relates e.g. to civil, commercial, real estate and court registries. Official access by credit bureaus to these data could improve the credit histories further, and increase the benefit for their users.

This is supported by empirical evidence. A significant number of credit bureaus in Europe use public records routinely as additional information sources to check the validity and to extent the information obtained from other sources, as the survey results in table 2 indicate.

Table 2

Sources of personal data: European Experience (Survey of 30 bureaus)

	Name	Address	Date of birth	Gender	ID/ tax ID	Bank-ruptcy	Court judgement
Client (Bank)	27	27	23	18	19	5	3
Public Records	11	11	9	8	6	15	13
Individual	4	4	3	3	3	0	0

Source: Rothemund, M., Gerhardt, M. (2011). The European Credit Information Landscape. An analysis of a survey of credit bureaus in Europa. Industry Survey. The European Credit Research Institute (ECRI).

Note: Above table reports the number of credit bureaus that answered a given question, out of a total of 30 responding bureaus (multiple answers possible).

While most bureaus obtain the name and address of a particular data subject directly from the banks (27 out of 30 bureaus), about a third of the European bureaus (11 out of 30) access also state databases for this kind of information. For other types of data, in particular registries of companies in bankruptcy proceedings and court judgements, about half of the bureaus make regularly use of these state databases. The information collected from different state databases is then used to check the validity and to extent the information obtained from other sources. Also information from individuals (data subjects) is collected in some cases.

In Ukraine, a problem mentioned by all bureaus, as well as other stakeholders, is the problematic official access to state databases and public records, which does not work properly. Especially the access to databases that are administered by the Ministry of Justice is considered problematic, as no free "real-time" access is possible. Furthermore, some "non-standard" bureaus apparently use informal data sources, i.e. engage in illegal trade in personal data, often originating from state databases. The use of data sources which cannot be verified (=accessed) by consumers is in no way acceptable, as it runs

against consumer data protection motivations and destroys the trust in the whole credit reporting industry.

A more detailed overview of the particular issues in accessing state databases reveals a mixed picture. Table 3 below lists the relevant public databases and registries and comments on the current degree of access.

Table 3

Access to Public Databases and Registries

Database	**Status/Comment**
Database of stolen/lost passports (MIA)	Apparently works now after initial problems
VAT Tax ID (STA)[14]	Web access
Single registry of companies and entrepreneurs (Min. of Justice/State registrar service)	Limited web access
Registry of licenses	Web access
Real estate registry, registry of mortgages (real estate) and liens of movable property (Min. of Justice /State company "Derzhinformjust")	Only paid access
Registry of civil acts	Available only to relatives and other interested parties (based on will, life insurance)
Court judgments/orders (State court administration)	Court orders are made available online but names of individuals are anonymised. Full decisions are available only to people influenced by the decision.
Bankruptcy/Insolvency registry	Paid access

Source: Own display

Note: MIA: Ministry of Internal Affairs; STA: State Tax Administration

The Draft Law #10292 recently submitted to Parliament[15] requires that all state registries provide information to credit bureaus in real time. The regulator should facilitate the access to public databases and serve as a vital information bridge between private bureaus and the different state sources. At the same time, the fight against the use of informal data sources must be stepped up from the side of the regulator. This would increase trust and confidence in the credit reporting industry, and ensure that lending is based only on proper (i.e. formal) information. This process could be further supported by the credit bureaus themselves. The development of an industry-wide "Code of Conduct", in which bureaus pledge to comply with fair principles in the process of information collection, would be a positive first step.

[14] Among credit bureaus in Ukraine, there is an intense discussion on the extent of access to tax information. Apart from identification purposes, and information on existing tax debt, a further access e.g. on income data etc. seems not in line with international experience.

[15] See chapter 4.4 for more information on this.

Recommendation 4: The regulator should facilitate the official access to state databases, a fact that is critical especially in early stages of market development. In particular, the Ministry of Justice should grant free "real-time" access of credit bureaus to its databases. At the same time, it should step up the fight against the illegal trade in personal data and become more active in prosecuting entities that violate the law. Credit bureaus should develop a "Code of Conduct" in which they promise to adhere to fair standards in information gathering.

4.3 Inclusion of Information Delivered by other Institutions

A broad database including all possibly relevant pieces of information is a key asset for credit bureaus, and helps banks to adequately assess the credit risks of as many borrowers as possible. While information supplied by banks and public sources ("segmented reporting") are indeed main input factors, non-bank financial institutions (NBFIs) and especially non-financial institutions offering deferred payments can also deliver important information ("comprehensive reporting"). Adding such data to credit bureaus' databases will improve credit availability especially for previously underserved individuals and SMEs, whose credit files lacked information that made a correct risk assessment impossible[16].

Among NBFIs, credit unions, insurance companies and leasing companies are potential data suppliers; non-financial data are usually provided by telecoms (mobile, fixed) and utilities (energy, water). Especially non-financial data providers are of interest, as their services are more widely used than financial services.

In Ukraine, but also in many other countries, a problem frequently encountered is that important pieces of information from such sources are not systematically included in the databases of credit bureaus. Regarding NBFIs, data are partially included. Larger credit unions based in cities are participating in certain credit bureaus, while rural or small credit unions are usually not interested. Some insurance companies also supply data and use credit bureaus. Data from non-financial companies is even scarcer. Retailers, telecoms and utilities are not among the information suppliers and users.

The reasons why such information suppliers are not being utilised to a fuller extent are complex. A written consent clause from the individual is needed in any case, but so far not included in most contracts. The general low level of interest among institutions other than banks may also be explained by the fact that the advantages of information sharing are not fully understood outside the financial sector.

In order to improve the situation, both the regulator and the bureaus should promote voluntary data submission by contributors across industries so that a comprehensive reporting can be achieved. More marketing efforts from the side of the credit bureaus might help, especially when the advantages of reciprocity agreements are clearly show to potential contributors. The focus should be especially on telecoms and retailers, i.e. on

[16] In this respect, Turner et al. (2006) found empirical evidence that when such "non-traditional" or "alternative" data suppliers were included, especially low-income individuals as well as minorities with previously no real access to credit benefited disproportionally.

the private sector, as (public) utilities are probably not yet ready for such data sharing. The regulator should give broad support to these efforts.

Recommendation 5: Comprehensive credit reporting includes also information provided by non-bank financial institutions, as well as by non-financial firms (telecoms, utilities). In Ukraine, there is still potential to include such additional data furnishers, a fact that credit bureaus should address with increased marketing efforts.

4.4 Preventing Data Fragmentation

A problem that is often observed among private credit bureaus competing for business relates to data fragmentation. This can take the form of a fragmentation across sectors (e.g. when data providers from different sectors report to different bureaus) or within a sector (e.g. data providers from the same sector, such as banking) report to different bureaus (Turner et al. 2009). An extreme form of this data fragmentation can be seen in the existence of "captive" bureaus, where banks – due to legal or regulatory reasons – are required or encouraged to submit data to at least one bureau, and thus some created their own bureau (e.g. Ukraine, Russia).

Data fragmentation observable in Ukraine has clearly a negative impact on the completeness of credit histories, and thus should be reduced. The more difficult question is how to achieve this in practice, and what instruments should be used. Should the regulator apply pressure, or put more emphasis on economic incentives? Or should this process be completely left to the shareholders of private bureaus in the hope that they might consolidate their assets?

While a single (monopolistic) bureau might appear at first glance ideal in terms of information pooling, other issues are here more important, especially in a dynamic perspective. In terms of innovation strength, cost efficiency, service orientation, and other factors there is no alternative to competition among private bureaus. Indeed, there is no strong empirical evidence for a natural monopoly in information sharing, so why should policy makers then push for a monopoly? Recent gains in information technology, which is a key determinant for the operations of credit bureaus, make this case even less compelling. Indeed, in many mature markets there is a tendency of an oligopolized market structure, with a number of private bureaus competing for business.

In Ukraine, two recent initiatives try to improve the still fragmented data landscape:

1) Voluntarily data exchange "One point of access"

This cooperation initiative by the two main bureaus "First All-Ukrainian Bureau of Credit Histories" and "International Bureau of Credit Histories" was announced in 2011. A major success of this cooperation agreement between bureaus is that banks can now access a bigger database at lower cost. Once a bank files a request with either of two bureaus, the bureau in question sends automatically a request to the other bureau. The role of the "Forum for Leading International Financial Institutions" in providing a platform for this dialogue and cooperation agreement should be highlighted.

The planned cooperation on data exchange between two leading bureaus is also quite promising in terms of a more formalised approach of cooperation in the future. Looking ahead, despite being in competition with each other, it might be very beneficial for private credit bureaus in Ukraine to found an industry association, plans which are already under discussion. This would give the bureaus the opportunity to represent the interests of its members better during policy discussions, to improve cooperation among them, to inform them on important matters and to reach a wider public audience. Many problems that we identified in this report, especially regarding information submission and sharing may be approached and eventually solved in the context of such a new institution.

2) Draft Law #10292 "On changes to legislative acts to improve activities of credit bureaus"

The Draft Law was registered in Parliament on 30 March 2012 and includes a number of points meant to improve the operations of credit bureaus. In the following we concentrate on a central feature of this draft, the creation of a central index of credit histories stored in different private credit bureaus.

This central index follows the experience of Russia, which has a rather fragmented credit information landscape. Currently, there are 33 private bureaus licensed, after more than 100 initially. The Central Bank of Russia keeps a central index of credit histories, where is recorded in which particular bureau(s) credit histories of data subjects are stored[17]. This index performs the function of a single information centre, informing banks in what particular bureau they can find credit history information about a subject.

In Ukraine, the situation is not exactly comparable to Russia, as only a much smaller number of bureaus exist. Among them, there are only about 3 established bureaus, which can be considered "standard" bureaus. The benefit of using such an index appears therefore more limited, in our view.

Recommendation 6: As in every competitive market with several private bureaus, data fragmentation is an issue in Ukraine, and needs to be tackled. The recently announced voluntary cooperation mechanism "One point of access" is a step in the right direction, and should be further developed. In the future, the creation of an industry association of credit bureaus might be the right forum for extending such activities. Establishing a central index of credit histories under public administration may also help to improve data fragmentation, even though the benefits are somewhat less clear.

[17] It is important to note that this index only informs about the existence of credit information stored in a particular bureau, but not the information itself. In a second step, banks need to address the bureaus for the credit history report.

5. Consumer Protection Issues

5.1 Privacy Data Protection

All around the globe, credit bureaus need to comply in their work with various laws and regulations regarding the protection of sensitive personal data. While in practice the concrete form can differ significantly from country to country, the general respect of the private and confidential nature of such data is undisputed. Any improvement in information sharing in terms of full and comprehensive reporting must be seen in combination with the development of adequate data protection systems, which give the data subjects wide-ranging rights to access, dispute and correct their stored data (Asian Bankers' Association, 2008). Thus, effective information sharing must be continuously balanced with protecting the privacy of the individual (IFC, 2006).

In Ukraine, credit bureaus have to comply with requirements of the relatively new data protection law[18], which entered into force on 01 January 2011. This means in practice that they have to register their database in a state register, inform anyone if they store his personal data in their database and provide the person with her/his data contained in the database. A new and material change in the law says that bureaus must now ensure that any personal data they obtain from external sources other than banks and other lenders is gathered in full accordance with the law. This means that that the consent of the subject has been given.

The business model of "standard" credit bureaus is in general not impacted by the new data protection law. However, the law is still in the initial stage of implementation. A number of the provisions of the law is vague and may be interpreted ambiguously. This may create previously unanticipated issues for credit bureaus but data protection requirements by the credit bureau law and licensing requirements for credit bureaus should be sufficient to satisfy the new legal requirements. The supervisor must ensure that credit bureaus obtain information only from legal sources, don't use illegal sources, and don't leak gathered information to other parties. Inquiries to credit bureaus must be restricted to only authorized parties, and for permissible purposes. Due to on-going concerns in the sector that a number of officially licensed "non-standard" bureaus use such illegal information, the main problem as of now seems the strict implementation and enforcement of the norms of the law.

Recommendation 7: The new data protection law in Ukraine is somewhat vague, but if implemented correctly provides sufficient privacy protection and seems balanced between privacy and business efficiency objectives. However, the full enforcement of the norms foreseen in the law by the responsible state authorities will be the key issue.

[18] Law of Ukraine No. 2297-VI "On Protection of Personal Data", from 01 June 2010. The Law is based on the "Council of Europe Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data", which was ratified by Ukraine in 2010.

5.2 Credit Collection Agencies

Credit collectors are individuals or institutions (e.g. collection agencies) that regularly collect debts owed to other parties like banks. Especially in Ukraine after the crisis, with its huge increase in non-performing loans (especially among consumer loans), the activities of such agencies have become more prominent.

In Ukraine, the current legal framework prevents such credit collection agencies from legally accessing credit histories. While the civil code allows the transfer of the right to collect debt to third parties, the credit bureau law does not take this into account. A related problem is that no information from credit collection agencies activities feeds back into the system. In case the debt is eventually settled, this would be vital information for the credit history of the subject in question.

The Draft Law #10292 mentioned above allows anyone with the right to claim the debt access to credit history. Thus, also credit collectors can now get access to credit bureaus' databases. However, it must be noted that the collection business in Ukraine is still not appropriately licensed, regulated and supervised. A special law regulating the activities of such agencies is missing. This is why a number of stakeholders are skeptical of the idea to let collection agencies access credit histories stored in bureaus' databases. Such a step could be taken once the collection industry is properly regulated and supervised.

Recommendation 8: The access of credit collection agencies to credit histories should be granted only after the industry is fully regulated and under strong supervision. Otherwise, this may damage the credibility of the whole the credit reporting system.

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