

In-Pro: Quarterly Dispatch on Financial Inclusion & Social Protection



IN FOCUS: WHY DO WE NEED RESPONSIBLE AND TRUSTWORTHY AI IN DIGITAL LENDING?

5 mins read

Picture this: You are scrolling through Facebook, seeing advertisements of a geyser you googled a few days ago. Your next paycheck is still a few days away. Suddenly, an advertisement appears that seems to have heard your thoughts - *“Get an instant personal loan starting at 10,000 rupees through XYZ Finance! No paperwork, instant approval.”*

A few taps later, you have downloaded this app, granted all the permissions it asked for and applied for the loan. Within minutes, your bank account has enough money for you to buy that geyser. Problem solved, without waiting for month-end.

But wait, what just happened behind the scenes?

On the surface, all you did was tap the screen a few times. Behind the scene, a fintech’s AI system has sifted through your transactional history, location, contacts, phone usage patterns, payment and shopping apps on your phone (probably even what you had for your dinner!) to market a personal loan to you. For the average Indian consumer, these loan nudges are now routine.

Today, a potential borrower’s digital footprint is vast. Borrowers who were previously ‘invisible’ are being met by fintech apps eager to serve them. Fintechs (Lending Service Providers (LSPs) in the regulator’s rulebook) use multiple data points to identify and target potential borrowers on behalf of regulated entities (REs) like a bank or NBFC. Over time, AI models appear set to get more sophisticated, enabling far more accurate customer acquisition predictions. AI systems are embedded at several nodes in the customer lending journey. LSPs may use AI systems to target, hyper-segment and route customers to regulated entities. The underwriting may happen based on the LSP’s AI system or some regulated entities may even have their proprietary underwriting algorithms. Other vendors may be engaged in monitoring the use of the loan, offering tailored communication including repayment reminders, further enhancing the customer’s loan experience.

But how safe is this swanky, instant credit-decisioning?

As AI systems grow more sophisticated and capable, they are also becoming more rampant. Insights from the RBI’s Framework for Responsible and Ethical Enablement of Artificial Intelligence (FREE AI) Committee Report signal that lenders are using AI primarily for (a) **customer support (15.6%)**, (b) **credit underwriting (13.7%)**, (c) **sales and marketing (11.8%)** and (d) **cybersecurity (10.6%)**. There is also a strong interest in use of **Generative AI (67%)**. However, this AI integration brings its own set of risks, arising from:

(i) **the very data that shapes it. Obsolete, inaccurate or skewed datasets introduce the risks of bias and model-misfit. Inappropriate methods of data collection and processing open personal data to the risks of privacy breaches and security incidents,**

(ii) **the model. Models may pick up and amplify bias from the data. As models become more complicated, their lack of explainability, potential for hallucination and overestimation of their capabilities become prominent risks.**

Moreover, closer collaboration between REs and LSPs to embed AI may also mean blurred accountability, complicated personal data handling and inadequate grievance redressal mechanisms for the borrower.

So, should we not be using AI in lending?

Using AI for lending enables lenders to extend credit to individuals who have been historically difficult to serve. There are ways to use AI in a manner that suppresses its risks and accentuates its benefits. There is a growing support for the paradigm of responsible and trustworthy AI (RTAI) that emphasises designing, developing and deploying AI in an ethical, transparent, explainable and safe manner.

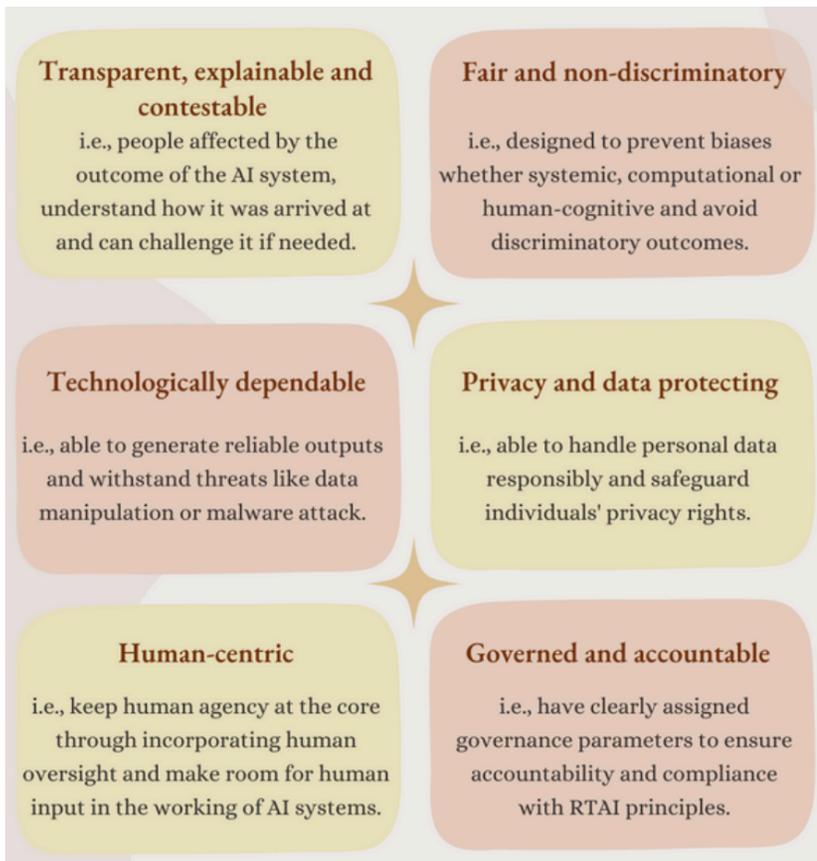
Okay! Let’s talk more about RTAI

It is a composite of several processes that ensure AI systems function as intended, uphold fair practices while ensuring the risk of unintended consequences is minimised. When AI-driven decisions are fair, respect privacy and are transparent, they foster regulatory and customer confidence and trust in them. The RTAI processes typically cover the entire Model Development Life Cycle (MDLC) from model designing to development, deployment and post-deployment monitoring.

RESPONSIBLE AI IS A PREREQUISITE FOR RESPONSIBLE LENDING. EARLY EXPERIENCE WITH AI HAS SHOWN THAT WHEN MODELS ARE NOT TESTED WELL, THEY CAN SANCTION LOANS TO THOSE WHO MAY NOT HAVE THE ABILITY TO REPAY. THIS CAUSES DISTRESS AT SCALE AND SIMULTANEOUSLY AFFECTS PORTFOLIO QUALITY AND SYSTEMIC HEALTH.

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Though there are several definitions and frameworks of RTAI, our RTAI framework that draws from leading global and domestic, academic and regulatory literature, identifies the following foundational RTAI principles:



How can we implement RTAI: A Checklist for digital lenders may be a first step

Going over several RTAI frameworks available in India and overseas, and building on the work of regulators such as the Monetary Authority of Singapore, Dvara Research in partnership with PwC India has created a list of processes in the form of a self-assessment checklist that can help lenders conform to the demands of RTAI.

For REs and LSPs, adoption of the RTAI checklist is one pathway to evaluate how closely they align with widely recognised RTAI standards. Many players, particularly those early in their AI journey, who are still looking for practical guidance on how to implement these principles may find the checklist useful.

The RBI's FREE AI Committee recently reinforced the importance of such a checklist, recommending development of AI compliance toolkits to help REs validate, benchmark and demonstrate compliance against key RTAI principles. While our toolkit cannot guard against all risks from AI, it is a necessary first step towards using AI responsibly.

RELATED READINGS

- [Responsible and Trustworthy AI tool](#)
- [Summary of the RBI FREE AI Committee Report](#)
- [Responsible AI in digital lending](#)
- [Responsible and Trustworthy AI in Digital Lending: From Principles to Practices](#)
- [How to develop trustworthy AI in digital lending](#)

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- [Transformative social protection: Do we understand what we are transforming?](#)

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- [Policy Research vs Academic Research](#)
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- [Assessing the Borrower-Level Impact of the Insolvency and Bankruptcy Code: A Study of the Fresh Start Process](#)



As digital lenders embrace AI, first movers to do so responsibly will be the ones who win in these unsettling times, where trust and transparency are more valuable than ever.

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