

Research Article**CREDIT BY ALGORITHM: REGULATING DIGITAL LENDING IN INDIA****Dr. B. Sravanthi¹, Durshetty Sai Krishna²**¹Assistant Professor of Law and Research Supervisor, University College of Law, Telangana University.²LL.M. Research Scholar, University College of Law, Telangana University.**Corresponding Author: Dr. B. Sravanthi.****Abstract**

The Reserve Bank of India (Digital Lending) Directions, 2025 define digital lending as a remote and largely automated process running through six stages, from customer acquisition to recovery. One of those stages is credit assessment. It is the only area that the Directions leave unregulated.

Every operative obligation in the Directions attaches to what surrounds the assessment rather than to the assessment itself: the Key Fact Statement and the annualized rate, disbursement into the borrower's own account, the cooling-off period, the conduct of recovery, grievance redressal, and the public directory of lending applications. An applicant refused credit by a model receives none of it.

The regulator is not unaware. Its own Committee on a Framework for Responsible and Ethical Enablement of Artificial Intelligence reported in August 2025 that regulated entities already deploy artificial intelligence in credit underwriting, and recommended disclosure of its use together with a human right of override. That report is advisory. It binds nobody.

This article argues that the resulting gap is regulatory rather than legislative. The Reserve Bank already possesses the power it would need, and has exercised that power comprehensively at every stage of a digital loan except the stage that decides whether the loan is made at all. The argument is tested against the Directions, the Credit Information Companies (Regulation) Act, 2005 and the applicant's existing right of access to credit information, the Digital Personal Data Protection Act, 2023, and the standard of proportionality applied to Reserve Bank regulation in *Internet and Mobile Association of India v. Reserve Bank of India*. It concludes that assessment can be brought within the framework by direction, without amendment to any statute.

Keywords: Digital lending, credit assessment, algorithmic underwriting, Reserve Bank of India, FREE-AI.

I. INTRODUCTION

Somewhere in India, several thousand times a day, a loan application is refused by a machine. The applicant has entered a few details on a phone and waited a moment. In that moment the lender's system has drawn on the credit bureau record, past transactions and the device itself, and reduced the applicant to a number. The number decides. The screen reports only that the application could not be processed at this time.

That is not really a reason. It is simply the absence of one, stated politely. And under Indian law, there is nothing that requires a lender to provide anything more.

Had the answer been yes, the law would have had a great deal to say. The applicant would have received a Key Fact Statement disclosing the annualized cost of the loan. The money would have had to move directly into the applicant's own bank account. There would have been a period in which to walk away without penalty, rules on who could bear the credit risk, limits on how repayment could be pursued, and a named lender findable in a public directory.

If the answer is yes, all of these consequences follow. If the answer is no, they do not.

Addressing bankers at Mumbai in August 2026, the Governor of the Reserve Bank put a question to the industry: whether “you shape the AI journey or let it shape you by default.”¹ The same address warned that wider use of artificial intelligence carries the risk of biased or opaque decisions, and cautioned that reliance on a small number of models or vendors could expose the system to shared error.²

The warning is accurate. What is striking is that it was addressed to banks rather than embodied in a direction to them.

Nor has the subject escaped the regulator’s notice. The Directions of 2025 define digital lending to include credit assessment, so the assessment stage lies squarely within the declared perimeter. The Reserve Bank’s own expert committee examined artificial intelligence in financial services and delivered a detailed framework in August 2025.³ And the Bank has ample power to issue binding directions in the interest of banking policy and to regulate non-banking financial companies.⁴

The perimeter exists. The diagnosis exists. The power exists. The obligation does not. This article examines that gap. It sets out how Indian law has historically regulated credit, what the 2025 Directions actually require, what happens at the assessment stage that they do not reach, and what the Reserve Bank’s own committee has said about it. It then turns to a statutory right that already exists and stops just short of the point at which it would be useful.

II. OBJECTIVES

The study has five objectives.

1. **To trace the evolution of Indian legal regulation of lending**, with particular emphasis on the regulation of lending terms and enforcement practices rather than the underlying decision to extend credit.
2. **To analyse the regulatory framework established by the Reserve Bank of India’s 2025 Directions**, particularly the scope of their application and the stages of the digital lending process that remain outside their operative reach.
3. **To examine the regulatory gap at the credit assessment stage of digital lending**, including the breadth of data inputs, proxy-based exclusion, unexplained rejection of applications, and the potential for systemic and discriminatory outcomes arising from algorithmic decision-making.
4. **To examine the concerns identified by the Reserve Bank of India’s FREE-AI Report** and assess the disconnect between the risks recognised in the Report and the absence of corresponding binding regulatory obligations governing AI-driven credit assessment.
5. **To develop a proportionate regulatory framework for AI-driven digital lending**, focusing on reforms capable of implementation through regulatory directions and assessing their compatibility with the principles of proportionality applicable to Reserve Bank regulation.

III. HYPOTHESIS

The hypothesis of this study is that the absence of any rule governing credit assessment in Indian digital lending is a regulatory gap and not a legislative one.

Three propositions follow from it, and each is tested in the pages that follow.

First, that the Reserve Bank already holds every power it would need to regulate the assessment stage, and has used the same powers to regulate each of the other stages of a digital loan.⁵ If that is right, nothing turns on the absence of fresh legislation.

¹ Sanjay Malhotra, Governor, Reserve Bank of India, address at FIBAC 2026, Mumbai, 11 August 2026.

² Ibid.

³ FREE-AI Report, *supra* n. 5.

⁴ Banking Regulation Act, 1949, s. 35A; Reserve Bank of India Act, 1934, Chapter IIIB, ss. 45JA and 45L.

⁵ Banking Regulation Act, 1949, s. 35A; Reserve Bank of India Act, 1934, Chapter IIIB, ss. 45JA and 45L. The Directions of 2025 were themselves issued under these powers, which is the clearest evidence that the power extends to the subject.

Secondly, that the reason the stage remains unregulated is not that the problem is unknown. The regulator has examined it and published its conclusions, but in a form that binds nobody.⁶ The gap is therefore one of instrument rather than of understanding.

Thirdly, that the principle required to close the gap is already present in Indian law. An applicant for credit has, since 2006, been entitled to the material on which the credit decision rests; the right is simply confined to the bureau record and has not followed the decision as it has moved.⁷ What is needed is the extension of an existing principle, not the introduction of a new one.

If these propositions hold, the conclusion is that the assessment stage can be brought within the framework by direction alone.

IV. RESEARCH METHODOLOGY

The study is doctrinal. It asks what the law provides, not how often lenders behave in one way or another, and its conclusions concern the adequacy of the framework rather than the prevalence of any particular practice.⁸

The materials are primary and of four kinds.

The first is the body of binding regulatory instruments issued by the Reserve Bank: the Digital Lending Directions of 2025, the Master Direction on Credit Information Reporting of January 2025, and the Integrated Ombudsman Scheme.⁹ These are read closely, because the argument turns on what they say and, more importantly, on what they omit.

The second is the statutory material — the Reserve Bank of India Act, 1934, the Banking Regulation Act, 1949, the Credit Information Companies (Regulation) Act, 2005, and the Digital Personal Data Protection Act, 2023.¹⁰ These are examined both as sources of the regulator's power and as possible sources of a right in the refused applicant.

The third is decided case law, used for the principles it establishes: the control of interest, the duty of a secured creditor to deal with objections and give reasons, the deprecation of coercive recovery, the content of informational privacy, and the standard by which Reserve Bank regulation is judged.¹¹

The fourth is official and policy material that does not bind — chiefly the FREE-AI Report and the public addresses of the Governor.¹² This material is used for the regulator's own account of the problem, and its advisory status is itself part of the argument.

The method of analysis is in two movements. The first establishes the perimeter: it maps what each instrument governs, locates the assessment stage within the definition of digital lending but outside every operative obligation, and asks whether any other statute or right supplies what the Directions do not. The second tests whether the gap can be closed by direction: whether the power

⁶ FREE-AI Report, *supra* n. 5. The report is advisory. It creates no duty and confers no right.

⁷ Credit Information Companies (Regulation) Act, 2005, s. 21.

⁸ Doctrinal research proceeds by the analysis of primary legal materials — statutes, subordinate legislation, regulatory instruments and decided cases — in order to establish what the law is, how it is arranged and where it is incomplete. It does not measure market behaviour.

⁹ Reserve Bank of India (Digital Lending) Directions, 2025, dated 8 May 2025; Master Direction – Reserve Bank of India (Credit Information Reporting) Directions, 2025, dated 6 January 2025; Reserve Bank – Integrated Ombudsman Scheme, 2021.

¹⁰ Reserve Bank of India Act, 1934, Chapter IIIB; Banking Regulation Act, 1949, s. 35A; Credit Information Companies (Regulation) Act, 2005; Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, s. 13(3A); Digital Personal Data Protection Act, 2023.

¹¹ *Central Bank of India v. Ravindra*, (2002) 1 SCC 367; *Mardia Chemicals Ltd. v. Union of India*, (2004) 4 SCC 311; *ICICI Bank Ltd. v. Prakash Kaur*, (2007) 2 SCC 711; *Justice K.S. Puttaswamy (Retd.) v. Union of India*, (2017) 10 SCC 1; *Internet and Mobile Association of India v. Reserve Bank of India*, (2020) 10 SCC 274; *Maneka Gandhi v. Union of India*, (1978) 1 SCC 248.

¹² FREE-AI Report, *supra* n. 5; Sanjay Malhotra, addresses at FIBAC 2026, Mumbai, 11 August 2026, and at the FATF Private Sector Collaborative Forum, Mumbai, March 2025.

exists, whether the content of the rule has already been worked out, and whether a rule of that kind would survive the proportionality standard.

The study does not undertake any empirical survey, and its limits should be stated plainly.¹³

V. HOW INDIAN LAW HAS REGULATED CREDIT

The regulation of lending in India has always concentrated on the terms of the bargain and the conduct of its enforcement, rather than on the lender's decision to lend.

That emphasis is defensible and has a long history. Courts have controlled what a lender may charge and how interest may be compounded.¹⁴ They have controlled how a security interest may be enforced, and in doing so have insisted on something close to a duty of reasons: in *Mardia Chemicals* the Supreme Court held that a secured creditor must apply its mind to the borrower's objections and communicate why they were not accepted, a requirement Parliament then wrote into the statute.¹⁵ They have controlled how debts may be recovered, deprecating in the strongest terms the use of coercion by recovery agents.¹⁶

What the courts have never done is require a lender to explain a refusal. No such duty exists at common law, and none has been read into the banking statutes. A prospective borrower who is declined has, in Indian law, no more claim to an explanation than a shopper refused service.

That silence was tolerable for as long as the decision was made by a manager who could be met, argued with and persuaded, and for as long as refusal was an individual event rather than an automated one applied at scale to a population. Neither condition now holds.

VI. WHAT THE 2025 DIRECTIONS REQUIRE

The Directions issued on 8 May 2025 consolidated the framework built since 2022 and repealed what preceded them. They are a serious instrument and should not be undersold.

They require a Key Fact Statement to be furnished before the contract is executed, disclosing the all-inclusive annualised rate of charges, so that the price of the loan is stated in a form the borrower can compare.¹⁷

They require that money move directly between the borrower's bank account and the regulated entity, closing the pass-through accounts through which lending service providers once handled borrower funds.¹⁸

They give the borrower a cooling-off period of not less than one day, irrespective of the tenor of the loan, in which the loan may be exited on payment of principal and proportionate charges.¹⁹

They regulate default loss guarantee arrangements, so that the entity bearing the credit risk is identified and capped rather than concealed.²⁰

They require every digital lending application to be reported to the Reserve Bank and published in a public directory, which addresses the problem of applications that were simply untraceable.²¹

¹³ The study therefore does not establish how often credit is refused by automated means, nor how any particular lender builds or operates its model. Those are empirical questions. The conclusions here concern the adequacy of the framework, not the prevalence of any practice.

¹⁴ *Central Bank of India v. Ravindra*, (2002) 1 SCC 367.

¹⁵ *Mardia Chemicals Ltd. v. Union of India*, (2004) 4 SCC 311. Parliament gave effect to the Court's reasoning by inserting s. 13(3A) in the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

¹⁶ *ICICI Bank Ltd. v. Prakash Kaur*, (2007) 2 SCC 711.

¹⁷ Digital Lending Directions, 2025, provisions on the Key Fact Statement and the all-inclusive annualised rate of charges.

¹⁸ *Ibid.*, provisions on disbursement and repayment directly between the borrower's bank account and the Regulated Entity, without pass-through accounts of Lending Service Providers.

¹⁹ *Ibid.*, cooling-off or look-up period, being not less than one day irrespective of loan tenor.

²⁰ *Ibid.*, provisions on Default Loss Guarantee, consolidating the Guidelines on Default Loss Guarantee in Digital Lending, 2023.

Taken together, these requirements reflect the basic obligations of a mature consumer-protection system. They ensure that borrowers know the true cost of a loan, that the money reaches the correct account, that there is a way to exit the arrangement, that responsibility for risk is clear, and that the lender can be identified and contacted.

Every one of them presupposes that the loan has been granted.

The Directions govern the disclosure of a price, not the setting of it against a particular applicant. They govern the movement of funds, not the decision to move them. They give a right to exit a loan, not a right to understand a refusal. The instrument is comprehensive on the transaction and silent on the assessment, although the assessment is named in its own definition.

VII. THE ASSESSMENT STAGE

Four features of automated credit assessment matter for the argument, and none of them is presently subject to any binding rule.

A. The inputs are wider than the record

A traditional credit decision rested on the applicant's financial history. An automated one may rest on a far larger set of signals, some financial and some not: patterns of transaction, the device used, the applications installed on it, the manner in which a form is completed.

The applicant has no way of knowing which of these entered the decision, and no right to be told.

B. Exclusion operates by proxy

A model is not told to prefer applicants from particular localities, occupations or backgrounds. It learns from a record of past lending, and where that record reflects historical patterns of access to formal credit, the model reproduces those patterns without ever using a prohibited category.

The effect falls where credit was already scarce: on the first-time borrower with no bureau history, on the self-employed and the casually employed whose incomes are irregular, and on applicants from districts where formal lending has always been thin. These are the very borrowers digital lending was expected to serve.

The Governor has himself observed that regulation should not create unintended barriers to financial inclusion.²² The observation cuts both ways: an unregulated model can create them just as effectively as a badly drafted rule.

C. The refusal is unexplained and unappealable

A refused applicant is given no reason, no indication of which factor was decisive, and no route to human reconsideration. There is no forum, because there is no obligation whose breach could be alleged.

The consequence is not confined to the individual loan. A refusal may be recorded, may influence subsequent applications, and may shape the applicant's access to credit for years, without the applicant ever learning what happened.

D. The error is systemic

Where many lenders rely on similar models, similar data and a small number of vendors, an applicant excluded by one is likely to be excluded by all. What would once have been a single lender's misjudgments becomes exclusion from the market.

This is the risk the Governor identified in warning against dependence on a narrow set of models and vendors, and it is a risk of a different order from mis-selling or aggressive recovery, because the person affected never enters the system at all and therefore never appears in its complaint statistics.

VIII. THE REGULATOR'S OWN DIAGNOSIS

The Reserve Bank has already examined this problem and set out what should be done about it.

²¹ Ibid., provisions on reporting of Digital Lending Apps to the Reserve Bank's Centralised Information Management System and the publication of a public directory of such applications.

²² Sanjay Malhotra, Governor, Reserve Bank of India, address at the FATF Private Sector Collaborative Forum, Mumbai, March 2025, on regulation not creating unintended barriers to financial inclusion.

A committee constituted in December 2024 under the chairmanship of Dr. Pushpak Bhattacharyya delivered its report on 13 August 2025 on a Framework for Responsible and Ethical Enablement of Artificial Intelligence.²³ Its survey of regulated entities and fin techs found artificial intelligence already deployed in credit underwriting alongside customer support, sales and cyber security.²⁴

The report sets out guiding principles for the sector, among them that the use of artificial intelligence should be disclosed and that a human being should retain the authority to override the system, and that such systems should be designed and tested for fairness and inclusion.²⁵

Its recommendations are practical rather than inspirational. They contemplate a board-approved policy on artificial intelligence, governance across the model lifecycle from approval and testing to deployment and change control, independent validation, and the reporting of incidents.²⁶ This is, in substance, the framework the assessment stage requires. The difficulty is its status.

The report is advisory. It creates no duty, confers no right and founds no complaint. A regulated entity that ignores it entirely breaches nothing. An applicant refused by a model gains nothing from its existence, and cannot invoke it before the Ombudsman or a court.

The gap in Indian digital lending regulation is therefore of an unusual kind. It is not that the problem is unrecognised, nor that the analysis is missing, nor that fresh legislation is needed. It is that the regulator has produced its diagnosis in a form that does not bind, while its binding instrument was drafted around a different stage of the transaction.

IX. THE RIGHT THAT STOPS SHORT

Indian law does give the credit applicant one statutory right, and its shape is instructive.

Section 21 of the Credit Information Companies (Regulation) Act, 2005 entitles a person who applies for a credit facility to request from the credit institution a copy of the credit information it obtained about that person from a credit information company, and obliges the institution to furnish it.²⁷ The Act further requires accuracy, imposes privacy principles, and provides a route to have erroneous information corrected.²⁸ The Reserve Bank consolidated this framework in a Master Direction of January 2025,²⁹ and complaints against credit information companies lie to the Integrated Ombudsman.³⁰

This is a genuine and useful right, and it demonstrates that Indian law is entirely capable of giving a credit applicant a right of access to material used in the decision. But it reaches the input and stops there.

The applicant may obtain the bureau record. The applicant may not obtain the other data the lender used, may not learn how any of it was weighted, and may not learn what the model concluded or why. Where the bureau record is only one of many inputs, and in automated assessment it commonly is, a right confined to it discloses a fraction of the decision and leaves the operative part untouched.

The statutory architecture is thus already the right shape and merely too narrow. The principle that an applicant is entitled to know the material on which a credit decision rests is not a

²³ FREE-AI Report, *supra* n. 5.

²⁴ FREE-AI Report, *supra* n. 5: survey of regulated entities and fin techs recording deployment of artificial intelligence in areas including customer support, sales, credit underwriting and cyber security.

²⁵ FREE-AI Report, *supra* n. 5, guiding principles on disclosure of the use of artificial intelligence, human override, and design and testing for fairness and inclusion.

²⁶ FREE-AI Report, *supra* n. 5, recommendations on board-approved artificial intelligence policy, model governance across the lifecycle, independent validation and incident reporting.

²⁷ Credit Information Companies (Regulation) Act, 2005, s. 21(1) and (2).

²⁸ *Ibid.*, ss. 19, 20 and 21(3); Credit Information Companies Regulations, 2006.

²⁹ Master Direction – Reserve Bank of India (Credit Information Reporting) Directions, 2025, dated 6 January 2025, issued under s. 11 of the Credit Information Companies (Regulation) Act, 2005.

³⁰ Reserve Bank – Integrated Ombudsman Scheme, 2021, which extends to Credit Information Companies.

novelty to be introduced into Indian law. It has been there since 2006. It simply has not been extended to the material that now matters most.

The Digital Personal Data Protection Act, 2023 does not fill the space. It confers rights over the applicant's data and none over the decision taken about the applicant, and India has no equivalent of a right to an explanation of, or human intervention in, a solely automated decision producing a significant effect.³¹ Nor does the constitutional guarantee of informational privacy recognised in Puttaswamy supply the missing remedy, since it is directed at the collection and use of personal data rather than at the reasoning of a private lender.³²

X. SUGGESTIONS

Four reforms are proposed. None requires an amendment to any statute, and each can be affected by the Reserve Bank under powers it already holds.³³

First, the Directions of 2025 should be amended to add a chapter on credit assessment. The assessment stage is already within their definitional scope; what is required is that the definition be given operative content rather than left as a description of the market.

Secondly, a refused applicant should be entitled, on request, to the principal grounds of the refusal and to a human reconsideration of it. The obligation is modest. It does not require disclosure of proprietary model architecture, and the Supreme Court's reasoning in *Mardia Chemicals* shows that a duty to communicate reasons can be imposed on a lender without disabling lending.³⁴

Thirdly, the recommendations of the FREE-AI Report bearing on the credit lifecycle should be converted from guidance into binding direction for regulated entities whose systems materially affect the grant, pricing or refusal of credit: a board-approved policy, pre-deployment testing for exclusionary effect, documented human oversight, independent validation and periodic revalidation.³⁵ The work of drafting has largely been done; what remains is the decision to make it mandatory.

Fourthly, the right of access under Section 21 of the Act of 2005 should be extended, by direction, beyond the bureau record to the categories of data the lender relied upon in assessing the applicant. This requires no new principle, only the application of an existing one to a wider set of inputs.

Any such measure must satisfy the proportionality standard the Supreme Court applied to Reserve Bank regulation in *Internet and Mobile Association of India*.³⁶ A duty to give reasons for a refusal, on request, is a light restriction directed at a real harm, and is unlikely to fail that test. The requirement of fairness in procedure, which Maneka Gandhi placed at the centre of Indian public law, is not satisfied by a decision that no one is obliged to explain.³⁷

XI. CONCLUSION

The Reserve Bank has regulated digital lending seriously. The Directions of 2025 consolidated a scattered framework, priced the loan transparently, secured the flow of funds, curbed abusive recovery and made lending applications traceable. Measured against the position in 2020, the improvement is substantial and should be acknowledged.

But the whole of that achievement lies on one side of a line. It governs the loan that is made. It says nothing to the applicant to whom no loan is made, and nothing about the process by which that outcome was reached.

That silence is not an oversight of policy. It is a survival from an older understanding of what lending regulation is for, formed when the decision to lend was an act of human judgment inside a

³¹ Digital Personal Data Protection Act, 2023; Digital Personal Data Protection Rules, 2025.

³² Justice K.S. Puttaswamy (Retd.) v. Union of India, (2017) 10 SCC 1.

³³ Banking Regulation Act, 1949, s. 35A; Reserve Bank of India Act, 1934, Chapter IIIB, ss. 45JA and 45L.

³⁴ *Mardia Chemicals Ltd. v. Union of India*, (2004) 4 SCC 311.

³⁵ FREE-AI Report, *supra* n. 5, recommendations on board-approved artificial intelligence policy, model governance across the lifecycle, independent validation and incident reporting.

³⁶ *Internet and Mobile Association of India*, *supra* n. 6.

³⁷ *Maneka Gandhi v. Union of India*, (1978) 1 SCC 248.

bank and the law's concern was that the resulting bargain should be fair. The bargain is now well regulated. The judgment has been automated and left alone.

The Governor's question to the banking industry was whether it would shape the arrival of artificial intelligence or be shaped by it. The same question may fairly be put to the regulator. The perimeter has been drawn to include credit assessment, the analysis has been completed and published, and the power to issue binding directions has never been in doubt. What remains is to use it.

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³⁸ Ministry of Electronics and Information Technology, India AI Governance Guidelines (November 2025).