WHEN THE ALGORITHM SAYS NO: LEGAL ACCOUNTABILITY FOR AI-DRIVEN CREDIT SCORING AND LOAN REJECTIONS IN INDIA

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ABSTRACT

Indian lenders increasingly rely on machine-learning models and alternative data to score borrowers and reject loan applications within seconds. These systems widen access to credit but also produce opaque, potentially discriminatory and hard-to-contest decisions. This article examines whether Indian law offers an adequate accountability framework for AI-driven credit rejection. It surveys the Credit Information Companies (Regulation) Act, 2005, the Digital Personal Data Protection Act, 2023, the Reserve Bank of India's digital lending and responsible-AI initiatives, constitutional principles after *Puttaswamy*, and consumer protection law. It argues that the present framework is fragmented, lacks an express right to an explanation or human review, and leaves the allocation of liability among lenders, fintech partners and model vendors uncertain. The article concludes with targeted reforms: a statutory right to reasons, mandatory human review for adverse automated decisions, algorithmic audit duties, and non-delegable lender liability.

Keywords: algorithmic accountability; credit scoring; artificial intelligence; digital lending; DPDP Act 2023; right to explanation; RBI.

I. Introduction

A first-time borrower in a small town applies for a personal loan through a mobile app and is rejected within seconds. No officer reviewed the file, no reason is given, and the applicant cannot tell whether the cause was an income estimate, a thin credit history, or an inference drawn from phone data or location. This scenario is now routine in Indian consumer lending.

Automated underwriting is promoted as a tool for financial inclusion, particularly for the "new-to-credit" population that traditional bureau scores cannot assess. Yet the same technology raises three legal concerns: opacity (the borrower cannot understand the decision), bias (models may reproduce or amplify social disadvantage through proxy variables), and diffused responsibility (banks, NBFCs, fintech platforms and model vendors each point to one another). The central question of this article is whether Indian law ensures that someone can be held answerable when "the algorithm says no".

II. How AI-Driven Credit Decisions Work

Modern credit models go beyond repayment history. Lenders and their technology partners may use transaction data, device and app-usage signals, e-commerce behaviour, utility payments and geolocation to estimate default risk. Many such models, especially ensemble and deep-learning systems, are difficult to interpret even for their developers. Three features matter legally: the decision is often fully automated; it relies on data the applicant may not know was collected or inferred; and it is frequently produced by a third-party vendor or a lending service provider rather than the regulated lender itself.

III. The Existing Legal Framework

A. Credit information and sectoral regulation

The Credit Information Companies (Regulation) Act, 2005 regulates the collection and sharing of credit information and gives individuals the ability to access their credit information and seek correction of inaccuracies[1]. However, the Act was designed around bureau records, not around proprietary models that draw on alternative data. A rejection driven by a non-bureau

[1] *Justice K.S. Puttaswamy (Retd.) v. Union of India*, (2017) 10 S.C.C. 1 (India).

signal falls largely outside its protections.

The RBI's digital lending regime, most recently consolidated in its Digital Lending Directions of 2025 (building on the 2022 Guidelines), requires regulated entities to ensure transparency through key fact statements, restricts data collection to what is need-based and consent-backed, mandates grievance redressal, and holds the regulated entity responsible for the conduct of its lending service providers. Reserve Bank of India (Digital Lending) Directions, 2025 (May 8, 2025)[2]. The RBI's Fair Practices Code for NBFCs and its outsourcing norms reinforce the principle that outsourcing an activity does not outsource responsibility[3][4]. In 2025 the RBI-constituted committee also proposed the FREE-AI framework, recommending board-approved AI policies, model risk management, bias audits and grievance mechanisms for AI use in finance. Reserve Bank of India, Report of the Committee on Framework for Responsible and Ethical Enablement of Artificial Intelligence (FREE-AI) (Aug. 2025). Although these are largely supervisory in character, they supply the closest thing to an AI-specific duty of care for lenders.

B. Data protection law

The Digital Personal Data Protection Act, 2023 (DPDP Act) is the first horizontal data protection statute. It requires notice and consent (or another lawful ground) for processing personal data, obliges data fiduciaries to ensure completeness, accuracy and consistency of data where it is used to make a decision affecting the data principal, and grants rights of access to information about processing, correction and erasure, and grievance redress. Digital Personal Data Protection Act, 2023, No. 22 of 2023, India Code (2023), Sections 5, 6, 8(3), 11 to 13. The Act also provides for a Data Protection Board and significant financial penalties. Id. Section 18, 33.

Two limitations stand out. First, unlike Article 22 of the EU's General Data Protection Regulation, the DPDP Act contains no express right to object to a solely automated decision or to obtain human intervention and an explanation of the logic involved[5]. Second, broad

[2] *Reserve Bank of India, Guidelines on Digital Lending, RBI/2022-23/111, DOR.CRE.REC.66/21.07.001/2022-23 (Sept. 2, 2022)*
[3] *Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023 (Oct. 19, 2023)*
[4] *Reserve Bank of India, Master Direction on Outsourcing of Information Technology Services (Apr. 10, 2023)*
[5] *Compares Regulation (EU) 2016/679, art. 22, 2016 O.J. (L 119) 1, with DPDP Act Section 11–13*

exemptions and "legitimate use" grounds may narrow its reach, see DPDP Act Section 7, 17, and implementation under the DPDP Rules, 2025 is phased, so practical enforcement is still maturing[6].

C. Constitutional principles

In *Justice K.S. Puttaswamy (Retd.) v. Union of India*[7], the Supreme Court recognised privacy as a fundamental right and emphasised informational self-determination. Constitutional guarantees under Articles 14 and 21 primarily bind the State, and most lenders are private actors, so direct enforcement is limited.[8] *See* Even so, the constitutional values of non-arbitrariness, dignity and fair procedure inform how regulators should interpret statutory duties, and they apply with greater force to public sector banks and State-backed credit schemes.

D. Consumer protection

The Consumer Protection Act, 2019 treats banking and financial services as "services", so unexplained or erroneous rejection arising from a flawed model may be pleaded as deficiency in service or an unfair trade practice[9]. The RBI Integrated Ombudsman Scheme, 2021 offers a low-cost complaint route[10]. These remedies are, however, reactive and individual: the borrower must first discover that something went wrong, and ordinary consumers rarely have the means to challenge a statistical model.

IV. Gaps in Accountability

1. **No right to reasons.** Outside bureau-based decisions, no general statute requires a lender to state why an application was rejected. Without reasons, the borrower cannot correct data errors or contest discrimination.

2. **Proxy discrimination.** Variables such as pin code, device type or language settings can correlate with caste, religion, gender or income class. Anti-discrimination guarantees in the Constitution largely do not reach private lenders, and existing financial regulation

[6] *Digital Personal Data Protection Rules, 2025 (India) (notified Nov. 2025)*
[7] *Justice K.S. Puttaswamy (Retd.) v. Union of India, (2017) 10 S.C.C. 1 (India).*
[8] *India Constitution arts. 12, 14, 21*
[9] Consumer Protection Act, 2019, No. 35 of 2019, India Code (2019), Section 2(11), 2(42), 2(47)
[10] Reserve Bank of India, Reserve Bank – Integrated Ombudsman Scheme, 2021 (Nov. 12, 2021)

contains no explicit duty to test models for disparate impact.

3. **Fragmented liability.** When a rejection results from a vendor's model, the borrower faces a chain of entities. Regulatory principles make the regulated entity responsible, but the contractual and tortious allocation of liability among lender, platform and vendor remains unsettled, and proof of a defective model is difficult without access to it.

4. **Evidentiary asymmetry.** The borrower bears the practical burden of showing unfairness while the lender controls the data, code and documentation. Trade-secret claims over models can further frustrate scrutiny.

5. **Regulatory fragmentation.** The RBI, the Data Protection Board, consumer fora and sectoral regulators each address part of the problem, and none has a clear mandate over algorithmic fairness in credit.

V. Comparative Perspectives

The European Union treats solely automated decisions with legal or similarly significant effects as presumptively restricted under Article 22 GDPR[11]. In *SCHUFA Holding (Scoring)*, the Court of Justice of the European Union held that generating a credit score can itself amount to an automated decision where a third party draws strongly on it in deciding whether to grant credit, extending safeguards to the scoring stage[12]. The EU AI Act also classifies creditworthiness assessment of natural persons as a high-risk use[13]. In the United States, the Equal Credit Opportunity Act requires adverse action notices stating the principal reasons for denial[14], 1, and regulators have indicated that the use of complex algorithms does not excuse the duty to give specific reasons. These models suggest that explanation duties and bias controls can coexist with innovation in lending.

VI. Recommendations

1. **Statutory or regulatory right to reasons.** Require every regulated lender to provide, on rejection, the principal factors in a clear, non-technical form, together with how to

[11] Regulation (EU) 2016/679, art. 22, 2016 O.J. (L 119) 1
[12] Case C-634/21, *SCHUFA Holding AG (Scoring)*, ECLI:EU:C:2023:957 (Dec. 7, 2023)
[13] Regulation (EU) 2024/1689, annex III, S. 5(b), 2024 O.J. (L) 1689
[14] 5 U.S.C. § 1691(d)(2)

seek correction or review.

2. **Human review of adverse automated decisions.** Provide a time-bound right to request review by a competent human officer, mirroring the safeguards in comparable jurisdictions.

3. **Model governance and audit.** Convert the RBI's responsible-AI recommendations into binding directions covering documentation, validation, drift monitoring and periodic bias and disparate-impact testing, with supervisory access to models and training data.

4. **Non-delegable lender liability.** State expressly that the regulated entity is answerable to the borrower for decisions made through vendors or lending service providers, with contractual rights of recourse against them.

5. **Data minimisation for alternative data.** Prohibit use of data categories that bear no demonstrable relationship to repayment capacity or that act as proxies for protected characteristics.

6. **Coordinated oversight.** Establish formal cooperation between the RBI and the Data Protection Board, and equip consumer fora and the Ombudsman with technical expertise.

VII. Conclusion

Indian law is not silent on automated credit decisions, but its protections are scattered across data, banking and consumer statutes, and none squarely guarantees the borrower a reason, a human reviewer or a remedy against algorithmic bias. As AI underwriting expands, accountability cannot depend on voluntary best practice. A coherent framework that couples the access benefits of AI with enforceable duties of explanation, fairness and lender responsibility would better serve both financial inclusion and the constitutional commitment to dignity and non-arbitrariness.

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