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Preface

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ALGORITHMIC BIAS, FINANCIAL EXCLUSION AND THE MISSING RIGHT TO EXPLANATION: A REGULATORY DESIGN ANALYSIS OF INDIA'S AI-DRIVEN CREDIT MARKETS

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Abstract

India's AI-driven credit ecosystem, built on alternative data and the Account Aggregator framework, promises to extend formal finance to thin-file borrowers while silently importing historical patterns of exclusion into automated lending decisions. This paper identifies a regulatory design gap at the centre of that ecosystem. The Digital Personal Data Protection Act, 2023 confers a right to a summary of processing but no right to an explanation of an adverse automated decision and no right to contest it; the Reserve Bank of India's FREE-AI Committee Report (2025) articulates fairness and "understandable by design" as guiding Sutras without converting them into binding, auditable duties; and the RBI (Digital Lending) Directions, 2025 mandate disclosure and consent without requiring interpretability. Employing doctrinal analysis of the DPDP Act and Rules, the FREE-AI Report, SEBI Regulation 16C and the Digital Lending Directions, read against the Supreme Court's jurisprudence under Articles 14, 15 and 21, together with a focused comparison with the EU AI Act, Article 22 of the GDPR and the United Kingdom's principles-based model, the paper argues that a de facto right to meaningful explanation must be read into Sections 8(3), 11 and 13 of the DPDP Act. It proposes a three-tiered, ex-post sectoral framework: a functionally defined right to meaningful explanation of adverse credit decisions; a rebuttable presumption of discrimination upon prima facie proof of proxy-driven disparate impact; and an AI Credit Grievance Cell within the RBI's existing consumer protection architecture. A payment aggregator case study demonstrates the framework's operation.

Keywords: *Algorithmic bias, Right to explanation, DPDP Act 2023, RBI FREE-AI, Financial exclusion, Article 14, Indirect discrimination, AI governance*

1. Introduction

1.1 The Paradox of AI-Driven Inclusion

Formal credit in India has historically been rationed through instruments that presuppose documentation: bureau histories, salary slips, income-tax returns and collateral. For the large population working in the informal economy, these instruments do not measure creditworthiness; they measure prior inclusion.[1] Artificial intelligence (AI) models trained on alternative data, including Unified Payments Interface (UPI) transaction patterns, utility payments, mobile recharge regularity and device behaviour, promise to assess precisely these populations.[2] The Account Aggregator framework, under which consented financial information moves between Financial Information Providers and Financial Information Users, supplies the data plumbing for this expansion; Sahamati, the industry alliance of the ecosystem, reported more than 450 million cumulative consents by mid-2026.[3]

The risk is equally structural. A model trained on historical lending data inherits the exclusionary patterns of that history.[4] It need not process caste, religion or sex to reproduce outcomes correlated with them; proxy variables such as PIN code, device type, application usage and transaction frequency carry the demographic signal forward.[5] Inclusion at the aggregate level may therefore coincide with deepening relative exclusion for subgroups that were already disadvantaged, a phenomenon this paper terms the paradox of algorithmic inclusion and develops in Section 2.5.[6]

1.2 The Regulatory Gap

Indian regulators have recognised the risk but have not built the enforcement machinery to

[1] Hurley, M., & Adebayo, J. (2016). Credit Scoring in the Era of Big Data. *Yale Journal of Law and Technology*, 18(1), 148-216.
[2] Reserve Bank of India. (2021). *Report of the Working Group on Digital Lending including Lending through Online Platforms and Mobile Apps*. RBI. https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1189
[3] Sahamati. (2026, July 21). *Varta: The Sahamati Newsletter, June 2026 Edition* (Pulse: Ecosystem Stats). https://sahamati.org.in/varta-the-sahamati-newsletter-june-2026/; India's Account Aggregator Ecosystem Facilitates Nearly 3.8 Crore Financial Services in FY26. (2026, June 24). IANS (reporting Sahamati, *Data Unlocked Report FY26*).
[4] Barocas, S., & Selbst, A. D. (2016). Big Data's Disparate Impact. *California Law Review*, 104(3), 671-732.
[5] Id.
[6] Fuster, A., Goldsmith-Pinkham, P., Ramadorai, T., & Walther, A. (2022). Predictably Unequal? The Effects of Machine Learning on Credit Markets. *Journal of Finance*, 77(1), 5-47.

address it. The Reserve Bank of India's (RBI) Committee on the Framework for Responsible and Ethical Enablement of Artificial Intelligence (FREE-AI), constituted in December 2024 and reporting on 13 August 2025, articulated seven Sutras, including "Fairness and Equity" and "Understandable by Design".[7] The Report sets an agenda; it does not bind. The Digital Personal Data Protection Act, 2023 (DPDP Act) and the Digital Personal Data Protection Rules, 2025 (DPDP Rules) create a consent-and-access architecture but contain no analogue to Article 22 of the European Union's General Data Protection Regulation (GDPR).[8] The RBI (Digital Lending) Directions, 2025 require consent and disclosure but not algorithmic interpretability.[9] A first-time borrower rejected by an opaque model may therefore learn that her data was processed but cannot compel the lender to disclose the logic of the inference that excluded her.

1.3 Research Question, Thesis and Methodology

The paper asks how the DPDP Act, sectoral financial regulation and constitutional principle may be combined to yield an enforceable right to explanation and redress for adverse automated credit decisions in India. Its thesis is that the DPDP Act's architecture is formally compliant but substantively empty in the context of automated financial decisions. Because the Act contains no right to explanation and no right to contest solely automated decisions, and because the FREE-AI framework and the Digital Lending Directions articulate fairness without translating it into enforceable obligation, India's AI credit market operates in an accountability vacuum. A de facto right to meaningful explanation must accordingly be read into the DPDP Act through Articles 14 and 21 of the Constitution, and buttressed by a three-tiered sectoral framework administered through existing RBI institutions.

The methodology is doctrinal and comparative.[10] Primary sources comprise the DPDP Act and Rules, RBI and Securities and Exchange Board of India (SEBI) instruments, and Supreme Court jurisprudence. The comparative component examines the EU Artificial Intelligence Act,

[7] Reserve Bank of India. (2025). *Report of the Committee to develop a Framework for Responsible and Ethical Enablement of Artificial Intelligence (FREE-AI) in the Financial Sector* (Aug. 13, 2025). RBI. https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1306

[8] The Digital Personal Data Protection Act, 2023, No. 22, Acts of Parliament, 2023 (India); The Digital Personal Data Protection Rules, 2025, G.S.R. 846(E), Gazette of India, Extraordinary (Nov. 13, 2025) (India); Regulation (EU) 2016/679 (General Data Protection Regulation), 2016 O.J. (L 119) 1.

[9] Reserve Bank of India. (2025). *Reserve Bank of India (Digital Lending) Directions, 2025*, RBI/2025-26/36, DOR.STR.REC.19/21.07.001/2025-26 (May 8, 2025). https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12848

[10] Hutchinson, T., & Duncan, N. (2012). Defining and Describing What We Do: Doctrinal Legal Research. *Deakin Law Review*, 17(1), 83-119.

the GDPR and the United Kingdom's approach not as templates but as tests of transferability.[11] The analysis concentrates on credit markets. Insurance underwriting is discussed in Section 2.3 only insofar as it illustrates the same dynamic, and the proposals in Section 6 are framed for lending.

1.4 Structure of the Paper

Section 2 examines how historical exclusion becomes algorithmic risk and develops the paradox of algorithmic inclusion. Section 3 analyses the statutory vacuum in the DPDP Act and Rules. Section 4 examines the sectoral instruments and develops the constitutional anchor under Articles 14, 15 and 21. Section 5 undertakes the comparative analysis. Section 6 sets out the proposed framework and applies it to a payment aggregator case study. Section 7 answers objections, Section 8 critically evaluates the proposal, and Section 9 concludes.

2. The Anatomy of Algorithmic Exclusion in Indian Credit Markets

2.1 Historical Data Biases and the Proxy Problem

The historical footprint of Indian formal credit is uneven. It has concentrated in urban and semi-urban areas, among salaried borrowers, and within social groups that have enjoyed generational access to banking.[12] A model trained on this record does not encounter a neutral sample of creditworthy and uncreditworthy persons. It encounters a sample in which entire categories of persons are absent, and in which the presence of a credit history is itself a function of historical access.[13] Default, moreover, is not a pure function of individual conduct. It is shaped by income volatility, emergency expenditure and dependence on informal credit, each of which is structured by caste, class and geography.[14] A model that learns that applicants from a given PIN code default at a given rate is not learning a natural fact about that locality; it is learning a history of state neglect and income insecurity that the PIN code proxies. When that inference is applied to the next applicant from the same locality, historical exclusion is converted into a forward-looking risk assessment, and the loop closes.

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[11] Zweigert, K., & Kötz, H. (1998). *An Introduction to Comparative Law*(3rd ed., T. Weir trans.). Oxford University Press.
[12] Reserve Bank of India. (2015). *Report of the Committee on Medium-term Path on Financial Inclusion*(Chair: Deepak Mohanty). RBI.
[13] Supra at 4.
[14] Collins, D., Morduch, J., Rutherford, S., & Ruthven, O. (2009). *Portfolios of the Poor: How the World's Poor Live on $2 a Day*. Princeton University Press (drawing on financial diaries from India, Bangladesh and South Africa); International Labour Organization & Institute for Human Development. (2024). *India Employment Report 2024: Youth Employment, Education and Skills*. ILO.

2.2 The Gig-Economy Blindspot

NITI Aayog estimated India's gig and platform workforce at 7.7 million in 2020-21 and projected that it would reach 23.5 million by 2029-30.[15] The earnings of such workers are lumpy, multi-platform and seasonal. Models calibrated on the cash-flow regularity of salaried borrowers read that volatility as risk, although it reflects the structure of the work rather than the reliability of the worker. The Code on Social Security, 2020 recognises gig and platform workers as statutory categories, yet credit models remain free to treat the defining feature of those categories as a negative signal.[16] Where alternative-data models are trained disproportionately on early digital adopters, who are likely to be younger, urban and male, the model's conception of "normal" financial behaviour is calibrated to that population, and divergence from it is scored as anomaly.[17]

2.3 Insurance Pricing and Demographic Penalties

The same dynamic extends to insurance. Underwriting and pricing models that draw on historical claims and health data may disproportionately penalise lower-income groups exhibiting higher baseline morbidity, a consequence of unequal access to care rather than of individual risk behaviour.[18] The EU AI Act classifies AI systems used for risk assessment and pricing in life and health insurance as high-risk for precisely this reason.[19] Indian insurance regulation imposes no equivalent fairness-testing obligation, although the policyholder protection framework of the Insurance Regulatory and Development Authority of India (IRDAI) supplies a regulatory hook for one.[20]

2.4 Empirical Evidence of Disparate Impact

Evidence specific to India remains limited, and claims must be stated with corresponding caution. Peer-reviewed analysis of National Sample Survey data on agricultural households establishes the historical baseline from which training data are drawn: relative to upper-caste households, the likelihood of access to institutional credit is about 12 percentage points lower

[15] NITI Aayog. (2022). *India's Booming Gig and Platform Economy: Perspectives and Recommendations on the Future of Work*. Government of India.
[16] The Code on Social Security, 2020, No. 36, Acts of Parliament, 2020 (India), ss. 2(35), 2(61).
[17] Supra at 6.
[18] Organisation for Economic Co-operation and Development. (2020). *The Impact of Big Data and Artificial Intelligence (AI) in the Insurance Sector*. OECD.
[19] Regulation (EU) 2024/1689 (Artificial Intelligence Act), Annex III, point 5(c), O.J. L, 2024/1689, 12.7.2024.
[20] Insurance Regulatory and Development Authority of India (Protection of Policyholders' Interests and Allied Matters of Insurers) Regulations, 2024 (India).

for Scheduled Tribe households, and a large share of the gap in credit amounts for Scheduled Tribe and Scheduled Caste households is not explained by differences in landholding, expenditure or education.[21] Comparative evidence points in the same direction. Research on the United States mortgage market finds that machine-learning models can widen rate disparities across racial groups even while improving aggregate predictive accuracy, and that algorithmic lenders, although they discriminate less than face-to-face lenders, continue to charge minority borrowers higher prices.[22] The RBI's own survey within the FREE-AI process found that, among regulated entities reporting AI use, only 15 per cent used interpretation tools, 35 per cent validated models for bias and fairness (and then only at early development stages), 10 per cent maintained bias-mitigation protocols, and 18 per cent kept audit logs.[23] The risk, in short, is documented; the controls are not.

2.5 The Paradox of Algorithmic Inclusion

The evidence reviewed above permits the paradox identified in Section 1.1 to be stated with greater precision. Algorithmic credit can widen access in the aggregate while deepening relative exclusion for particular groups, and three mechanisms explain how both can be true at once. The first is a margin effect. Alternative data admits thin-file applicants who would previously have been refused, but those newly admitted tend to be priced higher or offered smaller limits, so that an increase in approvals may coincide with a widening of the gap in terms between groups; the United States evidence shows machine-learning models improving average accuracy while increasing the dispersion of rates across groups.[24] The second is selective legibility. Models built on digital footprints reward those who leave them, and digital footprints are unevenly distributed: the National Family Health Survey 2019-21 recorded that only about 54 per cent of Indian women had a mobile phone that they themselves used.[25] A woman whose transactions run through a household member's handset is not risky; she is invisible, and invisibility is scored as risk. The third is a feedback loop. Repayment outcomes are observed only for applicants who were approved, so the next model is trained on the

[21] Zeeshan, Khan, M. A., Shamim, T., & Khatoon, N. (2025). Caste Disparities in Institutional Credit Access and Their Implications for Sustainable Development in Rural India. *Discover Sustainability*, 6, Article 1137. https://doi.org/10.1007/s43621-025-01805-6
[22] Supra at 6; Bartlett, R., Morse, A., Stanton, R., & Wallace, N. (2022). Consumer-Lending Discrimination in the FinTech Era. *Journal of Financial Economics*, 143(1), 30-56.
[23] Supra at 7.
[24] Supra at 6.
[25] International Institute for Population Sciences & ICF. (2021). *National Family Health Survey (NFHS-5), 2019-21: India*. IIPS.

performance of those whom the last model favoured, and groups excluded at the outset remain under-represented in the data from which their creditworthiness is inferred.[26]

The regulatory consequence is that aggregate measures of inclusion, such as accounts opened, loans disbursed or consents processed, cannot reveal whether algorithmic credit is narrowing or widening the gap between groups. Only disaggregated measurement can do so. The framework proposed in Section 6 therefore combines an individual explanation right with aggregate, disaggregated reporting by the RBI: the first makes a single decision contestable, while the second makes the distributional pattern visible.

3. The Statutory Vacuum: The DPDP Act, 2023 and the Missing Right to Explanation

3.1 The Consent-and-Access Architecture

The DPDP Act permits the processing of personal data on two grounds only: consent, and certain enumerated legitimate uses.[27] Consent must be free, specific, informed, unconditional and unambiguous, signified by a clear affirmative action, and confined to the personal data necessary for the specified purpose.[28] Every request for consent must be accompanied by a notice describing the personal data and the purpose of processing.[29] The Act defines "processing" to include wholly or partly automated operations,[30] and therefore plainly reaches algorithmic credit assessment. What it does not do is attach any distinct consequence to the automation of a decision. The word "automated" appears in the definition of processing and nowhere in the catalogue of the Data Principal's rights.

3.2 Section 11 and the Limits of Transparency

Section 11 entitles a Data Principal to obtain a summary of the personal data being processed and of the processing activities undertaken, together with the identities of other Data Fiduciaries and Data Processors with whom her data has been shared.[31] This is a transparency right, not an explanation right. It entitles a rejected applicant to learn that her UPI history and

[26] Lakkaraju, H., Kleinberg, J., Leskovec, J., Ludwig, J., & Mullainathan, S. (2017). The Selective Labels Problem: Evaluating Algorithmic Predictions in the Presence of Unobservables. *Proceedings of the 23rd ACM SIGKDD International Conference on Knowledge Discovery and Data Mining*, 275-284.
[27] Supra at 8, ss. 4, 7.
[28] Id., s. 6(1).
[29] Id., s. 5(1).
[30] Id., s. 2(x).
[31] Id., s. 11(1).

device data were processed for credit assessment. It does not entitle her to learn how those data combined to produce a rejection, which features were most influential, or whether the inference was driven by a proxy correlated with a protected characteristic.[32] Section 12 permits correction and completion of inaccurate or incomplete data,[33] but correction presupposes knowledge of which data mattered. Section 13 obliges Data Fiduciaries to provide a readily available means of grievance redressal and requires the Data Principal to exhaust it before approaching the Data Protection Board of India.[34] A lender may discharge that obligation by replying that the application "did not meet internal risk parameters". Such a response is lawful under the Act as it stands. It is also substantively meaningless, because the Board cannot investigate a bias claim whose evidentiary foundation is locked inside a proprietary model. Nor can the Board supply the deficiency: its inquiry under Section 28 is directed to whether a provision of the Act has been breached, and because the Act imposes no duty to explain an automated decision, the Board has no statutory standard against which to examine the model's logic.[35]

The omission is a matter of legislative design rather than oversight. The Justice B.N. Srikrishna Committee considered, and declined to recommend, a free-standing right to object to automated decisions, preferring to rely on impact assessments by significant data fiduciaries.[36] The 2023 Act moved further towards minimalism, dropping several Data Principal rights found in the Personal Data Protection Bill, 2019.[37]

There is, however, one textual foothold. Section 8(3) provides that where personal data is likely to be used to make a decision that affects the Data Principal, the Data Fiduciary shall ensure its completeness, accuracy and consistency.[38] The provision recognises that a consequential decision is a distinct moment of risk. Its logic, however, stops at the inputs. A model fed accurate data may still produce an arbitrary or discriminatory output; Section 8(3) secures the quality of the raw material but is silent on the inference built upon it.[39] Read with Section 8(1), which makes the Data Fiduciary responsible for compliance irrespective of any agreement to the contrary, and Section 8(4), which requires appropriate technical and organisational

[32] Supra at 4.
[33] Supra at 8, s. 12.
[34] Id., s. 13(1), (3).
[35] Id., ss. 27(1), 28.
[36] Committee of Experts under the Chairmanship of Justice B.N. Srikrishna. (2018). *A Free and Fair Digital Economy: Protecting Privacy, Empowering Indians*. Ministry of Electronics and Information Technology; PRS Legislative Research. (2018). *Summary: Report of the Committee of Experts on Data Protection*. PRS.
[37] The Personal Data Protection Bill, 2019, Bill No. 373 of 2019, Lok Sabha (India).
[38] Supra at 8, s. 8(3).
[39] Wachter, S., & Mittelstadt, B. (2019). A Right to Reasonable Inferences: Re-Thinking Data Protection Law in the Age of Big Data and AI. *Columbia Business Law Review*, 2019(2), 494-620.

measures, the provision nonetheless supplies the statutory hook on which Section 6 of this paper builds.[40]

3.3 The DPDP Rules, 2025 and Algorithmic Due Diligence

The DPDP Rules, notified in November 2025, operationalise consent notices, breach intimation, Consent Managers and Board procedure, with most substantive obligations commencing eighteen months after notification.[41] Rule 13 obliges Significant Data Fiduciaries to undertake an annual Data Protection Impact Assessment and audit and, by Rule 13(3), to observe due diligence to verify that technical measures, including algorithmic software, adopted by them are not likely to pose a risk to the rights of Data Principals.[42] This is the closest Indian law comes to an algorithmic accountability duty. Three limitations confine it. It applies only to fiduciaries notified as significant under Section 10, a designation that does not automatically capture digital lenders.[43] It is oriented towards systemic risk assessment rather than the individual decision. And it confers no right on the affected individual: an impact assessment may be conducted and filed without the rejected borrower ever learning of it.

3.4 The Consent Fallacy in Financial Services

A lending application's notice describing the collection of "device and usage data" for "creditworthiness assessment" cannot meaningfully disclose that the model will infer risk from application-open timestamps or transaction fragmentation. The purpose of "credit assessment" is broad enough to encompass an open-ended inferential exercise that the applicant could not have anticipated. Consent obtained at the threshold of a loan application is, moreover, structurally conditional, because refusal means no loan. The consent is formally valid and substantively empty: it legitimises the processing without informing the person whose livelihood turns upon it.[44]

3.5 The Training-Data Problem

When a borrower consents through an Account Aggregator to share bank statements for "loan assessment", the Financial Information User receives the data under a consent artefact

[40] Supra at 8, s. 8(1), (4).
[41] Supra at 8 (DPDP Rules), r. 1.
[42] Id., r. 13(1), (3).
[43] Supra at 8, s. 10(1).
[44] Solove, D. J. (2013). Privacy Self-Management and the Consent Dilemma. *Harvard Law Review*, 126(7), 1880-1903.

specifying purpose, data elements and duration.[45] If the user then trains or fine-tunes a general credit model on that data, it engages in a distinct processing purpose for which no consent was obtained, contrary to Sections 5 and 6.[46] Enforcement is nonetheless difficult. Training use is invisible to the Data Principal, and a model's parameters cannot be traced to the specific records that shaped them; erasure under Section 8(7) removes the record but not its imprint on the model.[47] The privacy violation and the bias risk are thus the same event viewed from two angles, because the composition of the training data determines whose financial behaviour the model treats as normal.

4. Sectoral Rules and the Constitutional Anchor

4.1 RBI FREE-AI: Principle Without Enforcement

The FREE-AI Committee, chaired by Professor Pushpak Bhattacharyya, organised twenty-six recommendations around seven Sutras and six strategic pillars. It identified algorithmic bias as a consumer risk; recommended that AI models used in credit and underwriting be explainable, auditable and free of discriminatory bias; proposed that customers be informed when interacting with AI and be able to challenge AI-driven decisions; and urged regulated entities to disclose their AI governance frameworks and grievance arrangements in annual reports.[48] The recommendations are well judged, but they remain recommendations. Until the RBI issues binding directions under Sections 21 and 35A of the Banking Regulation Act, 1949 or Section 45L of the Reserve Bank of India Act, 1934, a lender that deploys a biased model without interpretation tools or bias audits faces no FREE-AI-derived consequence.[49] The RBI's Working Group on Digital Lending had already recommended in 2021 that algorithmic features be documented and that lenders adopt ethical, explainable AI; those proposals have not been converted into enforceable standards.[50] The RBI's draft Guidance on Regulatory Principles for Model Risk Management, released for consultation in June 2026, would require regulated entities to define explainability thresholds for AI models and to assess them for bias and discriminatory outputs; it is, however, addressed to model governance within the institution

[45] Reserve Bank of India. (2016). *Master Direction -Non-Banking Financial Company - Account Aggregator (Reserve Bank) Directions, 2016*, DNBR.PD.009/03.10.119/2016-17 (Sept. 2, 2016) (as updated).
[46] Supra at 8, ss. 5, 6.
[47] Id., s. 8(7); Supra at 40.
[48] Supra at 7.
[49] The Banking Regulation Act, 1949, No. 10, Acts of Parliament, 1949 (India), ss. 21, 35A; The Reserve Bank of India Act, 1934, No. 2, Acts of Parliament, 1934 (India), s. 45L.
[50] Supra at 2.

and, in its draft form, confers no right on the affected borrower.[51] The distance between the Sutras and the survey figures recorded in Section 2.4 is the measure of that non-enforcement.

4.2 SEBI Regulation 16C: A Parallel Worth Drawing

SEBI's approach supplies an instructive contrast. Regulation 16C, inserted by the SEBI (Intermediaries) (Amendment) Regulations, 2025, provides that a regulated person using AI or machine-learning tools, whether developed in-house or procured from third parties and irrespective of the scale of use, is solely responsible for the privacy, security and integrity of investor data, for the output arising from those tools, and for compliance with applicable law.[52] The provision converts accountability for algorithmic output from a principle into a liability rule: the regulated person cannot plead the opacity of a vendor's model. Its limitation is that it allocates responsibility without specifying fairness standards or individual redress. Read with SEBI's framework for algorithmic trading by retail investors, which requires every algorithm to be identified, approved and traceable through audit trails, it demonstrates that Indian financial regulators already accept that an algorithm may not be deployed against market integrity without traceability.[53] There is no principled reason why a citizen's access to credit should receive less protection than the integrity of the order book.

4.3 RBI Digital Lending Directions, 2025: Disclosure Without Interpretability

The Digital Lending Directions consolidate and supersede the Guidelines on Digital Lending of 2022. They require a Key Fact Statement disclosing the annual percentage rate and all-inclusive cost of credit, mandate explicit and need-based consent for data collection, confine the data storage of Lending Service Providers, and require regulated entities to capture the economic profile of the borrower, including age, occupation and income, before extending credit.[54] These are meaningful protections addressed to pricing opacity and predatory data harvesting. They contain, however, no provision specifically addressing machine learning in credit assessment, no requirement to disclose the model used, no obligation to give an

[51] Reserve Bank of India. (2026). *Draft Guidance on Regulatory Principles for Model Risk Management, 2026*, paras. 9, 54 (released for public consultation, Press Release No. 2026-2027/528, June 24, 2026). RBI.
[52] Securities and Exchange Board of India (Intermediaries) (Amendment) Regulations, 2025, No. SEBI/LAD-NRO/GN/2025/226, reg. 16C, Gazette of India, Extraordinary, Part III, Section 4 (Feb. 6, 2025) (India).
[53] Securities and Exchange Board of India. (2025). *Safer Participation of Retail Investors in Algorithmic Trading*, SEBI/HO/MIRSD/MIRSD-PoD/P/CIR/2025/0000013 (Feb. 4, 2025). https://www.sebi.gov.in/legal/circulars/feb-2025/safer-participation-of-retail-investors-in-algorithmic-trading_91614.html
[54] Supra at 9, para. 7(i); Reserve Bank of India. (2022). *Guidelines on Digital Lending*, RBI/2022-23/111, DOR.CRE.REC.66/21.07.001/2022-23 (Sept. 2, 2022).

intelligible reason for an adverse algorithmic decision, no audit requirement, and no prohibition on proxy variables correlated with protected characteristics.[55] The residual obligation lies in the Fair Practices Code, which requires lenders to convey in writing the main reasons for rejecting a loan application.[56] In practice the obligation is discharged by boilerplate stating that the applicant "did not meet the lender's credit criteria". The Code demands reasons without demanding that the reasons be faithful to the model.

4.4 Article 14: Arbitrariness and the Unexplainable Decision

Since *E.P. Royappa v. State of Tamil Nadu,* Article 14 has been understood to strike at arbitrariness as the antithesis of equality.[57] *Maneka Gandhi v. Union of India* extended that understanding, holding that procedure affecting liberty must be right, just and fair and not arbitrary, fanciful or oppressive,[58] and *Shayara Bano v. Union of India* confirmed that manifest arbitrariness, meaning action that is capricious, irrational or without adequate determining principle, suffices to invalidate even legislation.[59] A decision whose basis cannot be stated to the person affected is, in the most literal sense, without a determining principle that the law can examine. The duty to give reasons has long been treated as an incident of non-arbitrariness: *S.N. Mukherjee v. Union of India* held that reasons exclude arbitrariness and make review possible, and *Kranti Associates v. Masood Ahmed Khan* described reasons as the heartbeat of every conclusion.[60]

The most directly relevant authority is *State Bank of India v. Rajesh Agarwal*. Confronted with RBI Master Directions on frauds that made no provision for hearing a borrower before her account was classified as fraudulent, the Supreme Court read the principles of natural justice into the Directions because classification entailed serious civil consequences akin to blacklisting, including exclusion from institutional finance.[61] The reasoning maps onto algorithmic credit with precision. An adverse automated decision, recorded through bureau

[55] Supra at 9; Agrawal, S., & Daga, D. (2025, August 9). Algorithmic Credit Risk Assessment and RBI's Ignorance: Time for Action. *Indian Review of Corporate and Commercial Laws* (blog). https://www.irccl.in/post/algorithmic-credit-risk-assessment-and-rbi-s-ignorance-time-for-action

[56] Reserve Bank of India. (2007). *Guidelines on Fair Practices Code for Lenders*, RBI/2006-2007/280, DBOD.No.Leg.BC.65/09.07.005/2006-07 (Mar. 6, 2007), para. 5; Reserve Bank of India. (2023). *Master Direction - Reserve Bank of India (Non-Banking Financial Company - Scale Based Regulation) Directions, 2023*, DoR.FIN.REC.No.45/03.10.119/2023-24 (Oct. 19, 2023) (Fair Practices Code).

[57] *E.P. Royappa v. State of Tamil Nadu*, (1974) 4 S.C.C. 3 (India).

[58] *Maneka Gandhi v. Union of India*, (1978) 1 S.C.C. 248 (India).

[59] *Shayara Bano v. Union of India*, (2017) 9 S.C.C. 1 (India).

[60] *S.N. Mukherjee v. Union of India*, (1990) 4 S.C.C. 594 (India); *Kranti Associates (P) Ltd. v. Masood Ahmed Khan*, (2010) 9 S.C.C. 496 (India).

[61] *State Bank of India v. Rajesh Agarwal*, (2023) 6 S.C.C. 1 (India).

enquiries and replicated by models trained on similar data, can exclude a borrower from formal credit as effectively as a fraud classification, and the regulatory instruments governing it are equally silent. *Rajesh Agarwal* establishes that silence in a financial regulatory instrument is no bar to implying a procedural guarantee where serious civil consequences follow.

4.4.1 The Rajesh Agarwal Mechanism: Implication, Consequence and Calibration

The method by which the Court reached that result supplies the template for the argument of this paper. The Master Directions on Frauds, 2016 required lenders to classify an account as fraudulent on the basis of a forensic audit and debarred borrowers so classified from institutional finance, but made no provision for notice or hearing.[62] The Court proceeded in three steps. First, it treated the silence of the Directions not as an exclusion of natural justice but as a gap, observing that nothing in their text or scheme excluded a hearing and that the time-lines they prescribed left room for one.[63] Secondly, it identified the consequence that made a hearing necessary: debarment from bank finance operated as a form of blacklisting, capable of amounting to civil death and of impairing the right to carry on business under Article 19(1)(g).[64] Thirdly, it calibrated the guarantee to that consequence, requiring notice of the forensic findings, an opportunity to respond and a reasoned order, while holding that natural justice did not attach at the stage of reporting a criminal offence.[65]

The sequel is equally instructive. In July 2024 the RBI replaced the 2016 Directions with revised Master Directions on Fraud Risk Management, which require a show cause notice setting out the transactions relied upon, a period of not less than twenty-one days to respond, and a reasoned order before any classification.[66] A procedural guarantee implied by the Court was thus codified by the regulator within sixteen months. That sequence, judicial implication followed by regulatory codification, is the two-stage path this paper proposes for the right to explanation in Section 6.1.

Applied to algorithmic credit, each step has a counterpart. The DPDP Act, the Digital Lending Directions and the Fair Practices Code are silent on the explanation of automated decisions but nowhere exclude it. An adverse automated decision carries consequences of the same kind, if not the same gravity, as a fraud classification: exclusion from institutional finance. And the

[62] Reserve Bank of India. (2016). *Master Directions on Frauds - Classification and Reporting by Commercial Banks and Select FIs*, DBS.CO.CFMC.BC.No.1/23.04.001/2016-17 (July 1, 2016), cls. 8.9, 8.12.
[63] Supra at 62.
[64] Id.
[65] Id.
[66] Reserve Bank of India. (2024). *Master Directions on Fraud Risk Management in Commercial Banks (including Regional Rural Banks) and All India Financial Institutions*, DOS.CO.FMG.SEC.No.5/23.04.001/2024-25 (July 15, 2024).

calibrated guarantee follows: notice corresponds to disclosure of the principal factors, the opportunity to respond to a right to correct and contest, and the reasoned order to an explanation faithful to the model. Because an ordinary credit refusal is less grave than a fraud classification, the calibration is correspondingly lighter, an explanation on request rather than a pre-decisional hearing, which is what Section 6.1 proposes.

4.5 Article 15: Proxy Discrimination and the Missing Disparate-Impact Doctrine

Article 15(1) prohibits discrimination by the State on grounds only of religion, race, caste, sex or place of birth, and Article 15(2) extends a horizontal prohibition to access to shops, public restaurants and similar spaces.[67] An AI credit model that never processes these attributes but relies on PIN code as a proxy for caste or religion, device type as a proxy for class, or transaction patterns as a proxy for gendered economic roles presents the doctrinal problem of indirect discrimination. The Supreme Court has recognised the concept. *Navtej Singh Johar v. Union of India* acknowledged that facially neutral rules may discriminate through their effects,[68] and *Lt. Col. Nitisha v. Union of India* incorporated indirect discrimination into the analysis under Articles 14 and 15, drawing on the Supreme Court of Canada's two-stage test in *Fraser v. Canada*.[69] What Indian law lacks is the operational apparatus: no settled statistical threshold for prima facie disparity, no allocated burden of justification, and no application to private lenders.[70] An applicant who suspects that a caste-correlated proxy shaped her rejection therefore has no evident route. The DPDP Act's remedies address data protection, not equality, and Article 15(1) does not bind a private lender directly. The equality guarantee exists in doctrine; the enforcement gap renders it inoperative in the market. Section 6.2 proposes a statutory presumption designed to supply the missing apparatus.

4.6 Article 21: Privacy, Dignity and Livelihood

Justice K.S. Puttaswamy (Retd.) v. Union of India located informational privacy within Article 21, required any intrusion to satisfy the tests of legality, legitimate aim and proportionality, and expressly identified profiling and inferential uses of data as distinct threats to autonomy.[71] *Suchita Srivastava v. Chandigarh Administration* recognised decisional autonomy over

[67] INDIA CONST. art. 15, cls. (1), (2).
[68] *Navtej Singh Johar v. Union of India*, (2018) 10 S.C.C. 1 (India).
[69] *Lt. Col. Nitisha v. Union of India*, (2021) 15 S.C.C. 125 (India); *Fraser v. Canada (Attorney General)*, 2020 SCC 28 (Canada).
[70] Khaitan, T. (2015). *A Theory of Discrimination Law*. Oxford University Press.
[71] *Justice K.S. Puttaswamy (Retd.) v. Union of India*, (2017) 10 S.C.C. 1 (India).

intimate life choices as a facet of personal liberty,[72] and *Olga Tellis v. Bombay Municipal Corporation* held that the right to life includes the right to livelihood.[73] For a street vendor, a gig worker or a smallholder, access to credit is a condition of livelihood. Opaque algorithmic exclusion therefore implicates Article 21 on two axes: it processes personal data to draw consequential inferences without a proportionate safeguard, and it forecloses economic participation without a reason the person can contest. The proportionality standard restated in *Modern Dental College and Research Centre v. State of Madhya Pradesh* asks whether a less restrictive means was available;[74] an explanation requirement is precisely such a means, preserving the lender's capacity to decide while removing the arbitrariness of unexplained exclusion.

4.7 Horizontal Application and the Public Functions Argument

The obvious objection is that lenders are, for the most part, private. *Federal Bank Ltd. v. Sagar Thomas* held that a private bank is not "State" under Article 12 merely because it is regulated by the RBI,[75] and *Phoenix ARC Pvt. Ltd. v. Vishwa Bharati Vidya Mandir* declined writ jurisdiction against a private asset reconstruction company.[76] The argument of this paper does not, however, depend on direct horizontal enforcement, and three routes remain. First, *Kaushal Kishor v. State of Uttar Pradesh* held that certain rights under Articles 19 and 21 may be enforced against non-State actors,[77] and *Andi Mukta Sadguru Trust v. V.R. Rudani* recognised that writs lie against private bodies discharging public duties.[78] Financial intermediation under licence from the RBI, on which livelihoods depend, is arguably a public function in that sense. Secondly, and more securely, the DPDP Act is legislation of the State and must be construed to conform with Articles 14 and 21. Where Parliament authorises the processing of personal data for consequential decisions, the presumption of constitutionality favours reading in a safeguard rather than imputing an intention to authorise arbitrariness.[79] Thirdly, *Rajesh Agarwal* itself carried natural justice into lenders' decisions through the medium of RBI directions, demonstrating that the regulatory instrument, rather than the identity of the lender,

[72] *Suchita Srivastava v. Chandigarh Administration*, (2009) 9 S.C.C. 1 (India).
[73] *Olga Tellis v. Bombay Municipal Corporation*, (1985) 3 S.C.C. 545 (India).
[74] *Modern Dental College and Research Centre v. State of Madhya Pradesh*, (2016) 7 S.C.C. 353 (India).
[75] *Federal Bank Ltd. v. Sagar Thomas*, (2003) 10 S.C.C. 733 (India).
[76] *Phoenix ARC Pvt. Ltd. v. Vishwa Bharati Vidya Mandir*, (2022) 5 S.C.C. 345 (India).
[77] *Kaushal Kishor v. State of Uttar Pradesh*, (2023) 4 S.C.C. 1 (India).
[78] *Andi Mukta Sadguru Shree Muktajee Vandas Swami Suvarna Jayanti Mahotsav Smarak Trust v. V.R. Rudani*, (1989) 2 S.C.C. 691 (India).
[79] Bhatia, G. (2019). *The Transformative Constitution: A Radical Biography in Nine Acts*. HarperCollins India.

is the vehicle by which constitutional values reach finance.[80] The de facto right to explanation is thus a matter of statutory construction informed by constitutional principle, which the Data Protection Board can apply and the RBI can codify.

5. Comparative Analysis: The EU AI Act, the GDPR and the Limits of Transfer

5.1 The EU Risk-Based Approach

The EU AI Act classifies AI systems intended to evaluate the creditworthiness of natural persons or establish their credit score, other than systems used to detect financial fraud, as high-risk.[81] Providers must operate a risk-management system, satisfy data-governance requirements directed at examining and mitigating bias, maintain technical documentation and logs, design the system for transparency towards deployers and for effective human oversight, and complete a conformity assessment before placing it on the market; deployers of credit-scoring systems must additionally conduct a fundamental rights impact assessment.[82] Most significantly for present purposes, Article 86 confers on any affected person subject to a decision based on the output of a high-risk system, which produces legal or similarly significant effects, a right to obtain from the deployer clear and meaningful explanations of the role of the AI system in the decision and of the main elements of the decision taken.[83] The high-risk obligations were originally scheduled to apply from 2 August 2026; the Digital Omnibus on AI, adopted as Regulation (EU) 2026/1744, has deferred the obligations for stand-alone high-risk systems listed in Annex III, which include credit scoring, to 2 December 2027.[84]

5.2 GDPR Article 22 and the Right to Explanation

Article 22 of the GDPR gives the data subject the right not to be subject to a decision based solely on automated processing which produces legal or similarly significant effects. Where an exception applies for contract, authorising law or explicit consent, suitable safeguards must be provided, including the right to obtain human intervention, to express a point of view and to

[80] Supra at 62.
[81] Supra at 19, Annex III, point 5(b).
[82] Id., arts. 9-15, 26, 27, 43.
[83] Id., art. 86(1).
[84] Id., art. 113; Regulation (EU) 2026/1744 of the European Parliament and of the Council of 8 July 2026 amending Regulations (EU) 2024/1689, (EU) 2018/1139 and (EU) 2023/1230 as regards the simplification of the implementation of harmonised rules on artificial intelligence (Digital Omnibus on AI), O.J. L, 2026/1744, 24.7.2026.

contest the decision; Articles 13(2)(f), 14(2)(g) and 15(1)(h) separately require meaningful information about the logic involved.[85] Whether these provisions together amounted to a "right to explanation" was long disputed.[86] The Court of Justice of the European Union has since narrowed the dispute considerably. In *SCHUFA Holding (Scoring)*, it held that the automated establishment of a probability value by a credit agency is itself a decision within Article 22 where a lender draws strongly upon it.[87] In *Dun & Bradstreet Austria*, it held that Article 15(1)(h) requires an explanation of the procedure and principles actually applied, in concise and intelligible form, enabling the data subject to understand which of her personal data were used and how; where trade secrets are asserted, the contested information must be disclosed to the supervisory authority or court, which balances the competing interests.[88] That last mechanism is directly relevant to the Indian design proposed below.

5.3 The United Kingdom and the FSB: Proportionate, Principles-Based Redress

The United Kingdom has followed a different path. Its government declined to enact a horizontal AI statute and instead asked existing regulators to apply cross-sectoral principles, including fairness, transparency and explainability, and contestability and redress.[89] The Financial Conduct Authority's Consumer Duty requires firms to deliver good outcomes for retail customers and to avoid causing foreseeable harm, standards that reach algorithmic decision-making without naming it.[90] The Data (Use and Access) Act 2025 replaced Article 22 of the UK GDPR with Articles 22A to 22D, relaxing the prohibition for most automated decisions while preserving safeguards of information, representation, human intervention and contestation.[91] At the international level, the Financial Stability Board has emphasised lifecycle risk management, governance and compensating controls where full explainability is technically limited.[92] The United States, though not a principal comparator, contributes a

[85] Supra at 8 (GDPR), arts. 13(2)(f), 14(2)(g), 15(1)(h), 22.
[86] Wachter, S., Mittelstadt, B., & Floridi, L. (2017). Why a Right to Explanation of Automated Decision-Making Does Not Exist in the General Data Protection Regulation. *International Data Privacy Law*, 7(2), 76-99; Selbst, A. D., & Powles, J. (2017). Meaningful Information and the Right to Explanation. *International Data Privacy Law*, 7(4), 233-242.
[87] *OQ v. Land Hessen (SCHUFA Holding)*, Case C-634/21, ECLI:EU:C:2023:957 (CJEU, Dec. 7, 2023).
[88] *CK v. Dun & Bradstreet Austria GmbH*, Case C-203/22, ECLI:EU:C:2025:117 (CJEU, Feb. 27, 2025).
[89] Department for Science, Innovation and Technology. (2023). *A Pro-Innovation Approach to AI Regulation*(CP 815). HM Government.
[90] Financial Conduct Authority. (2022). *A New Consumer Duty: Feedback to CP21/36 and Final Rules*(PS22/9). FCA.
[91] Data (Use and Access) Act 2025, c. 18, s. 80 (United Kingdom) (substituting Articles 22A-22D for Article 22 of the UK GDPR).
[92] Financial Stability Board. (2024). *The Financial Stability Implications of Artificial Intelligence*. FSB.

pertinent rule: Regulation B under the Equal Credit Opportunity Act requires a creditor to state the specific principal reasons for adverse action, and the Consumer Financial Protection Bureau has insisted that the complexity of an algorithm is no defence to that obligation.[93]

5.4 Why India Should Not Import the EU Model Wholesale

Three features of the Indian context counsel against transplantation. First, ex-ante conformity assessment presupposes a dense ecosystem of notified bodies, harmonised standards and accredited auditors. India has neither the standards nor the institutional capacity, and the cost would fall most heavily on the smaller non-banking financial companies and fintech lenders through which thin-file borrowers are actually reached. Secondly, a general prohibition on solely automated decisions sits uneasily with small-ticket digital loans whose economics depend on automation; the borrower's interest lies less in a human decision-maker than in a reason she can contest. Thirdly, India's AI governance policy has deliberately chosen a principles-based, innovation-oriented course, reflected in the FREE-AI Sutra of "Innovation over Restraint" and in the Ministry of Electronics and Information Technology's India AI Governance Guidelines of 2025, and projected internationally, including at the AI Impact Summit hosted in New Delhi in February 2026, as a development-centred alternative to the Brussels model.[94] A transplanted EU regime would contradict that positioning without securing its benefits, and would weaken India's claim to offer the Global South a distinct regulatory template.

5.5 A Proportionate, Sectoral, Ex-Post Alternative

The transferable elements are narrower and more valuable: the conception, common to Article 86 and *Dun & Bradstreet*, of an explanation measured by the individual's capacity to understand and contest; the American principal-reasons model; SEBI's allocation of sole responsibility for algorithmic output; and the British reliance on existing sectoral regulators. Combined, they yield a model that is ex-post rather than ex-ante, triggered by an adverse decision rather than by deployment, sectoral rather than horizontal, and administered by the RBI rather than by a new authority. Table 1 summarises the comparison, and Section 6 sets out that model.

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[93] 12 C.F.R. § 1002.9(b)(2) (United States); Consumer Financial Protection Bureau. (2022). *Consumer Financial Protection Circular 2022-03: Adverse Action Notification Requirements in Connection with Credit Decisions Based on Complex Algorithms*. CFPB.

[94] Supra at 7; Ministry of Electronics and Information Technology. (2025). *India AI Governance Guidelines* (Nov. 5, 2025). IndiaAI Mission, Government of India.

Table 1: Comparative design of explanation and redress regimes for automated credit decisions

Dimension	European Union	United Kingdom	United States	Proposed Indian model
Principal source	AI Act (high-risk, Annex III); GDPR arts. 15(1)(h), 22	UK GDPR arts. 22A-22D; FCA Consumer Duty	Equal Credit Opportunity Act; Regulation B	DPDP Act ss. 8(3), 11, 13 read with Arts. 14 and 21; RBI directions
Trigger	Deployment of a high-risk system; decision with legal or similarly significant effect	Significant decision based solely on automated processing	Any adverse action	Adverse automated or predominantly automated credit decision, on request
Individual explanation	Main elements of the decision (AI Act art. 86); logic involved (GDPR)	Information about the decision; right to make representations	Specific principal reasons	Three to five principal factors, their direction, and steps that may alter the outcome
Contestation	Human intervention and contest	Human intervention and contest	Through supervisory enforcement	Grievance officer, then AI Credit Grievance Cell review
Ex-ante burden	Conformity assessment; risk management; rights impact assessment	Principles-based; no AI-specific statute	None AI-specific	No new ex-ante regime; bias audits for Significant Data Fiduciaries and large lenders
Discrimination proof	Indirect discrimination; burden shifts on a prima facie case	Indirect discrimination under general equality law	Disparate-impact burden-shifting	Rebuttable presumption on prima facie proof of proxy disparity
Trade secrets	Disclosure to the authority or court	Not specifically addressed	No defence to the reasons	Technical disclosure to the RBI, not to the

Dimension	European Union	United Kingdom	United States	Proposed Indian model
	for balancing		requirement	individual
Institution	National authorities and data protection authorities	ICO and FCA	CFPB and prudential regulators	RBI (Cell) and Data Protection Board

6. A Framework for Enforceable Transparency and Redress

6.1 A Statutory Right to Meaningful Explanation

The first tier responds to the gap identified in Sections 3.2 and 4.3. A Data Principal subject to an adverse automated or predominantly automated credit decision, meaning a rejection, a reduction of limit, an adverse pricing decision or a freeze of funds, should be entitled on request to a meaningful explanation. "Meaningful" should be defined functionally rather than technically. The explanation must identify the categories of data that materially influenced the decision, the direction of their influence, the principal factors in order of significance (not fewer than three nor more than five), whether the decision was solely or predominantly automated, and the steps that might alter the outcome.[95] It need not disclose source code, model weights or architecture. Where a lender claims that a fuller explanation would reveal a trade secret, the *Dun & Bradstreet* mechanism should apply: disclosure to the regulator rather than refusal to the individual.[96]

Post-hoc attribution techniques such as SHAP (SHapley Additive exPlanations) and LIME (Local Interpretable Model-agnostic Explanations) make such explanations technically feasible at marginal cost,[97] and the FREE-AI finding that 85 per cent of reporting entities do not use interpretation tools indicates a market failure rather than a technical impossibility.[98] The right can be secured in two complementary ways. In the short term, the Data Protection Board should construe Section 11, read with Sections 8(1), 8(3) and 13, as requiring that the summary of

[95] Supra at 94; Kaminski, M. E. (2019). The Right to Explanation, Explained. *Berkeley Technology Law Journal*, 34(1), 189-218.
[96] Supra at 89.
[97] Lundberg, S. M., & Lee, S.-I. (2017). A Unified Approach to Interpreting Model Predictions. *Advances in Neural Information Processing Systems*, 30, 4765-4774; Ribeiro, M. T., Singh, S., & Guestrin, C. (2016). "Why Should I Trust You?": Explaining the Predictions of Any Classifier. *Proceedings of the 22nd ACM SIGKDD International Conference on Knowledge Discovery and Data Mining*, 1135-1144.
[98] Supra at 7.

"processing activities" include, where processing culminates in a consequential decision, the principal factors of that decision; this is the constitutionally conforming construction developed in Section 4.7. In the medium term, the RBI should codify the obligation by amending the Fair Practices Code and the Digital Lending Directions to require that the stated "main reasons" for rejection be faithful to the model, expressed in multilingual plain language, and delivered through the channels already used for the Key Fact Statement.[99]

6.2 A Rebuttable Presumption of Discrimination

The second tier responds to the doctrinal deficit identified in Section 4.5. Where an applicant, or a consumer organisation acting on aggregate data, demonstrates prima facie that a model relied materially on a variable statistically correlated with a protected characteristic, and that the model's adverse-outcome rate for the affected group is substantially higher than for comparable applicants, the burden should shift to the lender. The lender would then be required to establish that the variable serves a legitimate, non-discriminatory business necessity, that it bears a demonstrable relationship to repayment rather than a merely incidental correlation, and that no less discriminatory alternative of comparable predictive value was reasonably available.[100] The structure is a proportionality analysis familiar from *Nitisha* and *Modern Dental*, adapted from the indirect discrimination jurisprudence of the European Union and the burden-shifting framework of American fair-lending law.[101]

The presumption does not require proof of intent, an impossible burden in algorithmic contexts. It corrects an evidentiary asymmetry: the lender holds the model and the means to audit it, while the applicant holds neither. It also converts the FREE-AI recommendation of fairness audits from an aspiration into a rational precaution, because a lender that has not tested its model for disparate impact will be unable to rebut the presumption when it arises.

6.3 A Sectoral Grievance Mechanism Within the RBI

The third tier responds to the institutional gap. The Reserve Bank - Integrated Ombudsman Scheme, 2021 addresses deficiency in service but is not equipped for model-level disputes.[102] The RBI should establish an AI Credit Grievance Cell within its Consumer Education and

[99] Supra at 57; Supra at 9.
[100] Supra at 4.
[101] Supra at 70; Supra at 75; Council Directive 2000/43/EC, art. 2(2)(b), 2000 O.J. (L 180) 22; *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.*, 576 U.S. 519 (2015).
[102] Reserve Bank of India. (2021). *The Reserve Bank -Integrated Ombudsman Scheme, 2021*, CEPD.PRD. No.S873/13.01.001/2021-22 (Nov. 12, 2021).

Protection Department, empowered to require production of the explanation described in Section 6.1, to commission an independent technical review where the explanation is disputed, and to refer evidence of systematic bias to the Department of Supervision. The Cell would not adjudicate compensation; individual redress would continue through the Ombudsman and, for data protection violations, through the Data Protection Board. Its function would be diagnostic and supervisory, and it would publish aggregate findings by lender category, decision type and variable class without identifying complainants. The design implements the FREE-AI recommendation that customers be able to challenge AI-driven decisions and uses the RBI's existing supervisory leverage rather than creating a new regulator.[103]

6.4 Case Study: Agentic AI in a Payment Aggregator

Consider a payment aggregator authorised under the Payment and Settlement Systems Act, 2007 and the RBI's directions on payment aggregators.[104] It offers merchant cash advances through a partner non-banking financial company and deploys an agentic AI system that monitors settlement flows in real time, reassesses merchant risk, and autonomously varies credit limits or places holds on settlements. Meera runs a garment stall in a tier-3 town, accepts most payments through UPI, and has eighteen months of stable transaction history. Her application for an advance is declined. Two days later, the agent places a seven-day hold on her settlements, citing "anomalous transaction velocity". Her complaint to the aggregator's grievance officer under Section 13 of the DPDP Act returns an automatically generated reply repeating the same phrase.

Under the existing framework, the analysis ends there. The reply satisfies the formal requirement of Section 13; Section 11 yields only a summary confirming that her transaction data was processed; the Fair Practices Code is satisfied by the stated reason; and the settlement hold, characterised as risk management, falls outside the Ombudsman's usual terrain. Under the proposed framework, the sequence differs at each of four stages.

At the *explanation* stage, Meera requests a meaningful explanation. The aggregator and its lending partner must disclose that the decline and the hold were predominantly automated, and that the principal factors were settlement regularity, a festival-season spike in transaction

[103] Supra at 7.

[104] The Payment and Settlement Systems Act, 2007, No. 51, Acts of Parliament, 2007 (India); Reserve Bank of India. (2025). *Master Direction on Regulation of Payment Aggregators* (Reserve Bank of India (Regulation of Payment Aggregators) Directions, 2025), RBI/DPSS/2025-26/141, CO.DPSS.POLC.No.S-633/02-14-008/2025-26 (Sept. 15, 2025).

velocity, and device stability, with her entry-level Android handset contributing negatively. At the *challenge* stage, Meera, assisted by a traders' association holding aggregate data showing that merchants using entry-level handsets in the aggregator's tier-3 portfolio are declined at markedly higher rates than comparable merchants, contends that device type operates as a proxy for class and, through the geographic concentration of handset markets, for place of residence. That prima facie showing triggers the presumption. At the *justification* stage, the aggregator must demonstrate that device type predicts default independently of transaction behaviour and that no less discriminatory signal, such as settlement history alone, was available; it must also justify treating a predictable seasonal spike as an anomaly. If it cannot, the presumption stands. At the *supervisory* stage, the AI Credit Grievance Cell commissions an independent review, which finds that the velocity rule was calibrated on non-seasonal urban merchants, and refers the matter to supervision, which directs recalibration and a human-on-the-loop escalation for any settlement hold exceeding forty-eight hours.

The case demonstrates two features peculiar to agentic systems. Adverse action is taken continuously rather than at a single decision point, so the explanation right must attach to each adverse act and not merely to the initial application. And responsibility must remain with the regulated entity regardless of the agent's autonomy, consistently with Regulation 16C and the FREE-AI accountability Sutra.[105]

6.5 Implementation and Institutional Design

Implementation requires no new statute in the first instance. The Data Protection Board can issue guidance on Section 11; the RBI can amend the Fair Practices Code and the Digital Lending Directions under its existing powers; and the Central Government can notify large lenders deploying AI credit models as Significant Data Fiduciaries under Section 10, bringing them within Rule 13(3). A memorandum of understanding between the RBI and the Board should allocate jurisdiction functionally, assigning data protection breaches to the Board and fairness and model governance to the RBI.[106] Obligations should scale with exposure: the explanation right should apply universally, while annual bias audits and the full rigour of the presumption should attach to Significant Data Fiduciaries and to lenders above a prescribed portfolio threshold.

The functional allocation reflects the institutional design of the Board itself. The Act envisages

[105] Supra at 53; Supra at 7.
[106] Supra at 8, ss. 10, 27; Supra at 8 (DPDP Rules), r. 13(3).

a Board of a Chairperson and such number of members as the Central Government may notify, drawn from persons with expertise in fields that include data governance, dispute resolution, information and communication technology and techno-regulation, and directs that it function, as far as practicable, as a digital office.[107] Its adjudicatory task is to determine whether a provision of the Act has been breached and to impose the penalties prescribed in the Schedule.[108] A body so constituted is well placed to decide whether an explanation was given, but poorly placed to examine whether a credit model discriminates. The RBI, by contrast, already supervises the information technology governance, model controls and outsourcing arrangements of the entities concerned.[109] Assigning the explanation duty to the Board and model-level review to the RBI therefore matches each task to the institution equipped to perform it.

7. Objections and Responses

7.1 Compliance Costs and Innovation

It may be objected that an explanation right would impose excessive compliance costs and chill innovation. The cost of generating feature attributions for a declined application is marginal relative to the cost of the lending infrastructure itself, and the right is triggered on request rather than for every application.[110] The burden falls on lenders that have chosen opacity, not on the industry as a whole. The American experience is instructive: a principal-reasons obligation has coexisted with a large and innovative algorithmic lending market for decades.[111]

7.2 Technical Reliability of Explanations

Post-hoc methods approximate rather than reveal a model's logic, and they can be unstable or even manipulated to conceal a model's reliance on sensitive features.[112] The objection is valid but does not defeat the right. An approximate account of the features driving a decision is vastly superior to boilerplate. The framework can require disclosure of the method's limitations, empower the Cell to commission independent review, and, for the highest-impact decisions,

[107] Supra at 8, ss. 18, 19(3), 28(1).
[108] Id., ss. 27, 28, 33 and Schedule.
[109] Reserve Bank of India. (2023). *Master Direction on Information Technology Governance, Risk, Controls and Assurance Practices*, RBI/2023-24/107, DoS.CO.CSITEG/SEC.7/31.01.015/2023-24 (Nov. 7, 2023).
[110] Supra at 98.
[111] Supra at 94.
[112] Slack, D., Hilgard, S., Jia, E., Singh, S., & Lakkaraju, H. (2020). Fooling LIME and SHAP: Adversarial Attacks on Post hoc Explanation Methods. *Proceedings of the AAAI/ACM Conference on AI, Ethics, and Society*, 180-186.

encourage inherently interpretable models where any loss of accuracy is small.[113]

7.3 Frivolous Claims and the Presumption

The prima facie threshold requires statistical evidence of disparity and identification of a specific variable; suspicion does not suffice. The burden shift is calibrated rather than absolute, since the lender may rebut. In practice, the requirement of aggregate evidence will route most claims through consumer organisations and the Cell rather than through individual litigation, a structure familiar from discrimination law elsewhere.[114]

7.4 RBI Capacity for Model Review

The Cell would not review models itself. It would commission review from empanelled experts and academic institutions, much as the RBI already relies on external auditors for information-systems audits of regulated entities.[115] Its role is administrative and supervisory, and its demands on RBI staff are correspondingly modest.

7.5 Gaming and Trade Secrets

It may be argued that disclosure of principal factors will enable applicants to game models. The risk is overstated. Factors such as settlement history are costly to fabricate, and if a disclosed factor is easily gamed, that is evidence that it was a weak proxy for creditworthiness in the first place. Trade secrets are protected by confining individual disclosure to factors and routing technical disclosure to the regulator.[116]

7.6 Regulatory Overlap

Finally, two regulators acting on the same decision could produce inconsistent outcomes. The functional division proposed in Section 6.5, assigning data protection to the Board and fairness and model governance to the RBI, together with a formal memorandum of understanding, substantially mitigates that risk.

[113] Rudin, C. (2019). Stop Explaining Black Box Machine Learning Models for High Stakes Decisions and Use Interpretable Models Instead. *Nature Machine Intelligence*, 1(5), 206-215.
[114] Supra at 71.
[115] Supra at 110.
[116] Supra at 89.

8. Critical Evaluation

The existing framework deserves credit before its deficiencies are weighed. Four of its features are genuine achievements. The Digital Lending Directions curbed the predatory practices of unregulated lending applications by routing disbursal and repayment through the regulated entity, requiring a Key Fact Statement before the contract is executed, and making the regulated entity answerable for its Lending Service Providers.[117] The Account Aggregator architecture is consent-based by design: each data flow is tied to a consent artefact specifying purpose, data elements and duration, which gives Indian alternative-data lending a cleaner provenance than most comparator markets.[118] The FREE-AI Report is among the more sophisticated regulatory statements on AI in finance issued anywhere, and the draft model risk guidance of 2026 shows the RBI moving from principle towards supervisory expectation.[119] SEBI's Regulation 16C has closed the most obvious escape route by denying regulated persons the defence of vendor opacity.[120] The deficiency lies not in the direction of travel but in the absence of enforceable individual rights at its destination.

The proposed framework's principal strength is that it closes that specific gap without institutional overreach. It creates no new regulator, requires no omnibus AI statute, and draws on doctrines already recognised by the Supreme Court. It is not, however, free of vulnerability. First, reading an explanation right into Section 11 stretches the provision's text; the Board may decline to adopt that construction, and the Appellate Tribunal may reverse it.[121] Durable reform therefore requires RBI codification or legislative amendment, which is why Section 4.4.1 treats the *Rajesh Agarwal* sequence of implication and codification as the model rather than implication alone.

Secondly, the presumption depends on data that the framework itself makes difficult to obtain, and this tension deserves candid acknowledgement. Proof of disparity requires groups defined by caste, religion or sex, yet Indian lenders do not, and under the DPDP Act's principles of purpose limitation and data minimisation arguably should not, collect those attributes.[122] Recording caste in a credit file would itself create a risk of the very discrimination the presumption seeks to detect. Disparity will therefore usually have to be inferred from geographic and other proxies, so that the evidence of proxy discrimination is itself built from

[117] Supra at 9; Supra at 55.
[118] Supra at 46.
[119] Supra at 7; Supra at 52.
[120] Supra at 53.
[121] Supra at 8, s. 29.
[122] Supra at 8, ss. 5, 6(1).

proxies.[123] The comparative literature confirms that fairness testing without reliable demographic data is methodologically fragile, and that procuring such data raises privacy and trust concerns of its own.[124] Three partial answers are available: aggregate testing at the level of districts and PIN-code clusters, for which public census and survey data exist; testing within the RBI's regulatory sandbox on reference datasets held by the regulator rather than the lender;[125] and statistical guidance from the RBI so that the prima facie threshold does not vary from forum to forum. None removes the irony; each confines it.

Thirdly, the paper leaves three matters outside its scope. An explanation right operates only on decisions actually made; it does nothing for discouraged borrowers who never apply because they expect refusal, whose position depends on broader financial inclusion policy.[126] The framework governs regulated lenders and therefore cannot reach the informal credit market of moneylenders, traders and kin networks on which many rural households still depend, and to which a borrower refused by an algorithm may simply turn.[127] A regime that raised the cost of formal lending without reducing its opacity could push marginal borrowers in that direction, a risk that supports the light-touch, on-request design of the explanation right. Nor does the paper address credit information companies, whose bureau scores are among the most influential inputs into lending models and whose correction and dispute obligations are governed by a separate statute.[128] An explanation that names a bureau score as the principal factor merely relocates the opacity unless the score is itself open to comparable scrutiny; extending the framework to credit information companies is a natural subject for further work.

Finally, the horizontal reach of constitutional rights remains contested after *Federal Bank* and *Phoenix ARC*; the framework's reliance on statutory construction and regulatory codification is designed to avoid that controversy rather than to resolve it.[129] None of these limitations, however, favours the status quo, under which the same vulnerabilities exist without any mechanism of explanation or redress.

[123] Wachter, S., Mittelstadt, B., & Russell, C. (2021). Why Fairness Cannot Be Automated: Bridging the Gap Between EU Non-Discrimination Law and AI. *Computer Law & Security Review*, 41, 105567.
[124] Andrus, M., Spitzer, E., Brown, J., & Xiang, A. (2021). "What We Can't Measure, We Can't Understand": Challenges to Demographic Data Procurement in the Pursuit of Fairness. *Proceedings of the 2021 ACM Conference on Fairness, Accountability, and Transparency*, 249-260.
[125] Reserve Bank of India. (2024). *Enabling Framework for Regulatory Sandbox* (Feb. 28, 2024). RBI.
[126] Supra at 12.
[127] National Statistical Office. (2021). *All India Debt and Investment Survey: NSS 77th Round (January-December 2019)*. Ministry of Statistics and Programme Implementation, Government of India.
[128] The Credit Information Companies (Regulation) Act, 2005, No. 30, Acts of Parliament, 2005 (India), s. 21.
[129] Supra at 76; Supra at 77.

9. Conclusion

India's AI credit market stands at an inflection point. The infrastructure for alternative-data lending is in place; the accountability framework is not. The DPDP Act creates consent and access rights but stops short of explanation. The FREE-AI framework articulates fairness but does not bind. The Digital Lending Directions require disclosure of price and purpose but not interpretability of decision. The Fair Practices Code requires reasons but not reasons faithful to the model. The cumulative result is a regime in which algorithmic bias can operate without detection and financial exclusion can proceed without accountability.

This paper has argued that the gap is not merely one of policy preference but of constitutional significance. Under Article 14, as interpreted from *E.P. Royappa* to *Shayara Bano*, a consequential decision without a determining principle that the affected person can examine is arbitrary. *Rajesh Agarwal* demonstrates that the Supreme Court will imply procedural guarantees into silent financial regulatory instruments where exclusion from institutional finance is at stake. *Nitisha* recognises indirect discrimination, and *Puttaswamy* and *Olga Tellis* bring informational privacy and livelihood within Article 21. A de facto right to meaningful explanation can and should therefore be read into Sections 8(3), 11 and 13 of the DPDP Act.

Interpretation alone, however, is insufficient. The paper accordingly proposes a three-tiered framework, calibrated to Indian institutional capacity and rejecting the wholesale transplantation of the EU's ex-ante model: a functionally defined right to meaningful explanation of adverse credit decisions; a rebuttable presumption of discrimination upon prima facie proof of proxy-driven disparate impact; and an AI Credit Grievance Cell within the RBI that is diagnostic and supervisory rather than adjudicatory. The payment aggregator case study shows how the sequence of explanation, challenge, justification and supervisory referral converts an unanswerable rejection into a reviewable decision.

India's demographic realities, including its caste structure, its regional inequalities and its gendered access to financial infrastructure, are precisely the conditions under which algorithmic bias is most likely to cause harm and least likely to be detected. The regulatory design gap is therefore not abstract: it is the difference between a borrower who can contest her rejection and one who cannot. A credit system that promises inclusion while reproducing exclusion, governed by a legal framework that promises protection while delivering only procedure, is inconsistent with the constitutional commitments to equality, dignity and livelihood. True Digital India requires shifting the regulatory paradigm from protecting the Data Fiduciary's trade secrets to protecting the Data Principal's financial livelihood.

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