

AI-Based Credit Scoring Models in Microfinance: Improving Loan Accessibility, Risk Assessment, and Financial Inclusion

Muhammad Abdul Rehman¹, Manzoor Ahmed² & Dr Sonia Sethi³

¹The Islamia University of Bahawalpur, Email: marehman1992@yahoo.com,

ORCID: <https://orcid.org/0009-0009-3785-3449>

²Assistant Commissioner, Sindh Revenue Board, Government of Sindh, Email: manzoor.memon@iba-suk.edu.pk

³Lecturer, Department of Management Sciences, Islamia College Peshawar, Email: sonia.sethi@icp.edu.pk

ARTICLE INFO

Article History:

Received: February 01, 2025
Revised: March 06, 2025
Accepted: March 08, 2025
Available Online: March 10, 2025

Keywords:

Artificial Intelligence, Microfinance, Credit Scoring, Machine Learning, Financial Inclusion, Data Privacy, Risk Assessment, and AI-driven Credit Models

Corresponding Author:

Muhammad Abdul Rehman

Email:

marehman1992@yahoo.com

ABSTRACT

AI has made a huge impact in micro financing through the introduction of credit scoring models that have made loans easily accessible, reduced risks associated with lending while increasing the number and population covered by micro finance. The key traditional credit scoring measures that form the basis of conventional credit scoring models mainly base their decision on historical financial data, thus locking out people who do not have formal records with banks in the society. Symbolic models apply new sources of data, like use of mobile phones, transactions, social media accounts, and biometric data to make new credit scores for borrowers. The application of machine learning models will enhance lending decisions at the microfinance institutions, lower costs of operations, and reduce default risks. Nevertheless, there are certain drawbacks that are associated with the use of big data; issues such as data privacy, algorithms bias, meeting regulatory requirements, and technical constraints for MFIs. This paper aims at reviewing the advancement in credit scoring in the microfinance market, the techniques used to couple credit assessment using Artificial Intelligence, and the concerns towards the ethical practice of deploying Artificial Intelligence. It also provides examples of good practice in AI adoption and explores the potential of AI to increase financial inclusion. Despite the benefits that may be brought about by AI in assisting the process of micro financing, it is crucial to ensure fairness, transparency, and responsible use of the technology in microfinance.



Introduction

Micro finance is an essential tool for economic development since it offers financial services to the people and firms, especially those who cannot access mainstream formal banking facilities. They are particularly aimed at targeting needy persons in the society and help them access business opportunities, income-generating mechanisms and economic development. Thus, it can be concluded that, through contributing to financial inclusion, micro finance has facilitated poverty reduction as well as boosted social mobility especially in the developing world (Armendáriz & Morduch, 2010). Though, credit rating, financial access and portfolio risk measures largely define the ability of Microfinance institutions (MFIs) in meeting the credit needs of their clients.

One of the biggest problems that the MFIs confront is the problem of credit risk evaluation since many of their target borrowers do not possess traditional financials. For instance, the traditional methods of credit scoring as used by financial institutions majors on credit histories, income statements and other formal structured financial documents to assess applicants' creditworthiness (Banerjee et al., 2015). But, more than half of the microfinance clients are in the sector B economies where they have no earnings, assets, or credit records that could act as security. This constraint makes MFIs rely on techniques like the guarantees, groups, lending, ratings by loan officers, which causes inefficiency, higher default charges and incremental costs of operation as highlighted by Morduch (1999). Additionally, somehow, a considerable number of potential borrowers still cannot receive microfinance services because many approaches cannot work with non-conventional credit assessment frameworks (Dupas et al., 2018).

AI-based credit scoring models can enhance credit assessment in microfinance as outlined below. In contrast to the previous models that provided credit scores based on only numerical values of income and credit history, the AI based methods use any type of data on a person's behaviour, including using mobile phones, his activity in the social networks, the history of purchases and other actions to evaluate his creditworthiness (Fuster et al., 2019). In its approach, machine learning is capable of analysing big amounts of structured and unstructured data to find out the correlation that can signify responsibility or risk level. Thus, AI helps make the credit assessment process smoother and hopefully more inclusive, allowing MFIs to reach more people, and reduce preconceived notions that might disadvantage specific populations (Khandani, Kim, & Lo, 2010).

Furthermore, the use of AI in credit scoring models also enhances the assessment of credit risk and enhances the decision making on financial credits. The previous methods of credit scoring on the other hand are vulnerable to Bias, inconsistency issue and poor predictive analysis particularly in the expanded microfinance markets (Lessmann et al., 2015). AI models, on the other hand, can analyze borrower behavior in continual operation, recognizing risk signals that human analysts may neglect. Consequently, MFIs can thus have improved control over their portfolios, rates of interest, and loan defaults (Berg, Burg, Puri 2020). In addition, AI use in credit scoring makes credit granting faster and less expensive meaning that financial service provision becomes more practical and feasible (Philippon, 2019).

The objective of this review is to critically discuss the application of credit scoring models in microfinance with a view to evaluating the effects brought about by the use of these models on one hand on access to loans, risk management, and on the other, effect on financial inclusion. This paper will look at the advancement of credit scoring in microfinance, the process adopted by many firms in AI credit assessment, and the advantages and disadvantages of these technologies. Furthermore, the review shall seek to identify some of the ethical and legal realities that are

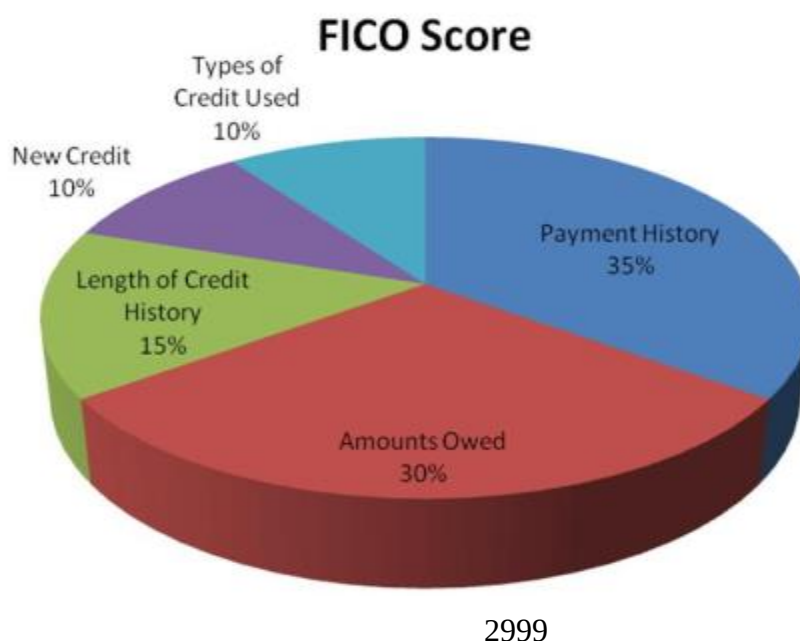
associated with the use of AI in financial decision making some of which includes but not limited to; algorithmic selection bias, data privacy and transparency (Barocas, Hardt & Narayanan; 2019). This paper aims to explore the possibilities of using AI in microfinance, taking into consideration the current developments and trends with the purpose of identifying how microfinance institutions can use AI in their operations while following the best practices of responsible and sustainable lending.

2. Evolution of Credit Scoring in Microfinance

Credit risk measurement was always one of the critical steps in decision-making processes within the field of finance. Previous credit scoring techniques have been very central in assessing the credit risk of anyone who wishes to borrow from the financial institutions. However, these methods have been developed mainly for the channels of banking paradigm where customers are expected to have documented banking legacies. Small business and rural retail customers who are not qualifying for credit of formal banking sectors are taken as the targeted customers of micro finance institutions (MFIs). Concerning quantitative approvals, it becomes completely evident that typical techniques of microfinance, such as FICO scores as well as manual credit rating, have failed to deliver the anticipated results in recent years.

FICO (Fair Isaac Corporation) is a global credit scoring model that is commonly accepted by financial institutions. It determines the credit-worthiness of an individual according to the past credit histories, outstanding credits, credit utilization ratio, the length of credit history and credits inquiries within the previous two years (Hand & Henley, 1997). FICO model provides a number that credit that decision makers use in making decisions on lending and the ability of the borrower to repay the loan. Although this system has provided a rational strategy in formatted banking, this strategy is restricted to achieving microfinance means. Many microfinance borrowers are in the relatively informal employment bracket, in which the bulk of them has no credit history, no accounts or any other method by which a financial profile of the borrower can be ascertained. Thus, many micro-entrepreneurs and persons with low income end up with low or no FICO score and thereby they cannot access credit (Agarwal et al., 2018).

Figure 1: FICO Score



Besides credit history reliance, FICO scores exclude behavioral and qualitative characteristics of the creditworthy character of a borrower. While, it relies on previous performance with regards to creditworthiness, it does not take into consideration any factors like economic downturns, fluctuating employment status, or suffering some form of misfortune and the effects it can have on repayment capacity of a loan (Chatterjee et al., 2020). This is unconducive when it comes to using FICO scores since MFIs target clients with unfixed and informal financial status. Thus, microfinance institutions have had to use other, more individual, criteria to assess credit risk.

Prior to the use of credit scoring models, MFIs relied only on a conventional credit scoring approach in order to assess risks of the applicant. One of the most frequently used methodologies for risk assessment was the character-based evaluation during which loan officers interviewed the potential borrowers and examined their spending habits, job security and honesty (Schreiner, 2001). Already discussed the loan officers used to visit the applicants at their home or workplace and the data collected during the home visit travelling was qualitative and included business activities, family support systems, living conditions and so on to deduce on the ability and willingness of the borrowers to repay the loans. However though this process was effective, it was not very scientific and name dependent on personal opinions. Several loan officers may have made different credit evaluations of the same applicant therefore coming to different credit-granting decisions (Churchill and Frankiewicz, 2006).

Figure 2: Credit Risk Assessment



Another traditional approach of microfinance was the group lending coupled with peer rating as pilfered by the Grameen Bank of bangladesh (Yunus, 2003). In this system, borrowers had to bring together a group of borrowers, where each of the members would ensure the repayment of the loans. This suggested that if one member keyed in a wrong input and his default ratio exceeded the limit of the group, the entire group would suffer a penalty. Corporations therefore affected discipline in their members by making the entire group suffer if one of them went against the correct procedure on savings. This peer-monitoring mechanism helped substitute for physical collateral, enabling financially restricted people to obtain credit. But not all was well with group lending since it was faced with the following challenges. Since it mainly relied on social collateral, it was successful in areas where people were closely related or where members of the community where both borrowers and lenders lived were closely related. Moreover, there are often conflicts

within the groups, which make some of the members forced to take financial responsibility for the other people who are in the group, as for example, Giné and Karlan (2014) reported.

Figure 3:



The other, more ordinary approach used by MFIs was the cash-flow analysis where the loan officers considered the daily cash flow patterns of the applicant. This method was especially helpful when tracking the financial transactions in the case of Kasarani's small-scale vendors and informal workers. Loan officers gathered data concerning income, business activity, and the applicant's expenditure levels and assessing against the likelihood of them fulfilling loan commitments (Porteous, 2006). The cash-flow analysis with a better understanding of a borrower's position during offering the credit was more time consuming, required significant resources, and prone to manipulations, as they can state high income while having low expenses.

However, despite attempts to apply mainstream credit evaluation models to the microfinance market, these methods continued to have some critical issues. The decision-making nature of the process based on human decision-making was slow and prone to errors and bias. Attempts at lending also had implicit decision-making based on personal experiences, cultural beliefs, and prejudices of the loan officers, thus bringing about disparities in lending (Armendáriz & Szafarz, 2011). Further, credit evaluation done manually was costly since it entailed fieldwork, data collection, and monitoring of borrowers' credit status. The high operational costs in many cases translated into high interest rates of microfinance loans and reducing the accessibility for the target population (Cull et al., 2009).

It will be important to note that as the basic methods of credit scoring propped up their shortcoming, there was an increasing demand for improved, accurate and efficient approaches to

risk evaluation with enhanced scalability. The advancement in technological front and the arrival artificial intelligent in the financial services was an opportunity that was interested for the MFIs to change their credit scoring`django`. The development of the AI credit scoring models was seen as a way to overcome the limitations of the FICO scores and the manual assessment of risks by using AI to gather more extensive sources of data and make predictions. AI's ability to integrate into the credit assessment procedure holds promise in reforming microfinance sector by widening the credit access and thus reducing risks for the investors.

Transition to AI-Based Models

They have shifted from conventional rule base credit scoring models to Machine learning techniques in credit scoring for microfinance. Earlier, the microfinance institutions (MFIs) use a qualitative assessment and rule of thumb to assess a borrower's creditworthiness. In microfinance, decision trees with Boolean credit risk decision trees and credit risk criteria were established and rule-based models were used to process eligibility of loans. It included such essential models as the income level, the previous loan repayment ability, and business performance. However, they failed to have flexibility, could not perform well in fluctuating economic conditions, and since they involved human interference, they had inherent biases (Hand & Henley, 2019). Also, they operated on the basis of structured financial records which in effect locked out anyone with no record with the formal financial institutions thus lack of financial inclusion.

Figure 4: Applications of AI-Based Credit Scoring



The application of machine learning-based algorithms in the computation of credit scores shifted focus to a more sophisticated approach compared to the previous rule-based systems. In particular, abnormalities in employing a large amount of borrower data, supervisors use minuted learning algorithms, whereby the latter involves identifying complex and nonlinear patterns of such behavior (Lessmann et al., 2015). Unlike the conventional methods which involve credit scoring on the basis of preset human established conditions, machine learning is capable of updates through fresh information and so is malleable in its decision making process. These models include almost all those that go beyond the credit history and use behavioral and transactional data giving better predictive power (Kou et al., 2021). For microfinance, this shift is particularly constructive

as it allows offering credit to financially excluded individuals who do not show up as creditworthy through standard practices, but demonstrate sound credit behaviors that can be measured via other criteria.

Use of Alternative Data Sources

Another positive effect brought by the use of artificial intelligence in credit scoring for microfinance organizations is that it uses more data sources. Usual credit scoring models rely on objective quantitative data available through credit bureaus, credit application histories, income reports, credit ratios and other formal records usually inaccessible to microfinance clients dealing in the informal economies (Rai et al., 2018). Credit scoring, however, employs new sources of data such as mobile phone usage in borrowing products, social media activities, e-commercial activities and payments of utility bills in the building of credit score (Bazarbash, 2019).

Mobile phone records have turned out to be an essential record in credit evaluation that draws on artificial intelligence. Nowadays, most MFIs examine call records, text message activity, and, most importantly, peoples' mobile payment transactions to determine creditworthiness (Bjorkegren & Grissen, 2020). For instance they said that borrowers who often recharge their mobile credit and have constant mobile payment transactions are regarded as financially responsible. Likewise, the analysis of social media data has emerged, in which machine learning models perform the prediction of credit risk based on digital footprints, stability of the professional network, and social interactions (Berg et al., 2020). The findings of this paper also indicated that customers /applicants with more positive social interactions and more often shall present lower incidence of credit defaults.

Electricity and water bills are also good examples of utilised bills which reveal one's level of the desired financial management. AI models use historical data on the borrowers' performances to tailor the last detail, which gives a better view of how the consumers pay back their debts (Varian, 2014). The e-commerce transactions, and the activities in digital wallet add more real-time spending data to the overall credit scoring model enabled by AI the constraints in financial behaviour (Philippon, 2020). Through the use of such new data sources, credit scoring through use of AI also enhances credit rating accuracy, thus allowing MFIs to reach out to new credit markets that were hitherto locked out.

Key Developments in AI-Driven Credit Scoring

The key trends that have impacted the development of AI approaches to credit scoring include the shift from the statistical models to the deep-learning ones and the use of AI by the growing population of financial technology (FinTech) firms. These changes have positively impacted microfinance through immigration on accuracy, pre-estimation, elimination of bias, and credit.

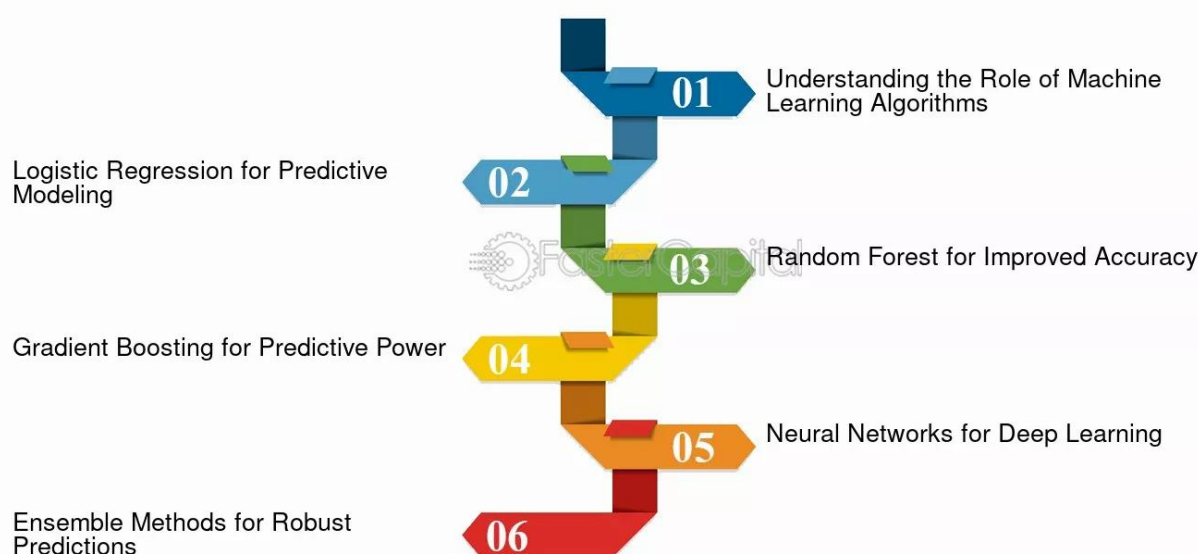
Evolution from Statistical Models to Deep Learning Algorithms

The initial forms of credit scoring used in microfinance organizations crucially included the statistical analytical procedures like logistic regression and derivations including decision trees. These models have been of some use however, their ability to model complex systems was hampered by the straightforward mathematical constructs on which they were based (Lessmann et al., 2015, p.276). For instance, logistic regression models presuppose linear association between financial behaviors and creditworthiness that rarely captures borrower patterns appropriately. Two improvements over logistic regression existed; that of decision trees that adopted more flexible

rule-based classifications, but the model poorly generalised and demanded intense human intervention in choosing parameters.

The use of Deep learning algorithms has contributed positively towards increasing efficiency and effectiveness of credit risk evaluation. Artificial neural networks (ANNs), convolutional neural networks (CNNs), and recurrent neural networks (RNNs) consume heavy volumes of unstructured data and detect patterns that other models cannot (Goodfellow et al., 2016). As opposed to ordinary statistical models, the deep learning methods assess higher-dimensional datasets and identify relationships between the type of alternative data and repayment behaviours. Numerous empirical evidence exists showing that deep learning techniques perform better compared to traditional credit scoring methods especially in addressing high false positive problems and improving the forecasting of default rate (Zhang et al., 2018).

Figure 5: Machine Learning Algorithms for Credit Score Enhancement



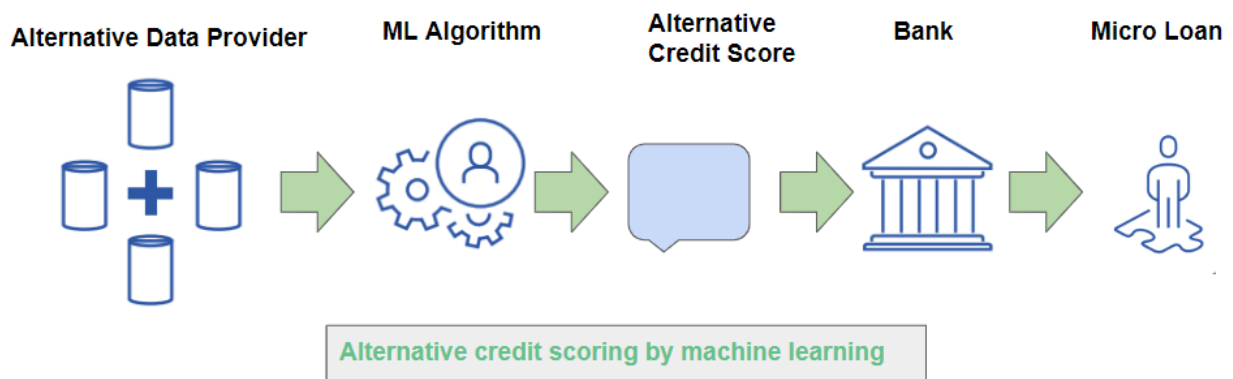
In addition, the use of NLP and sentiment analysis for credit scoring aspect of creditworthiness has also provided a new frontier for evaluating borrowers' authenticity. Customer interactions, financial narratives, and textual descriptions from loan applications may be considered by AI models to recognize potential indicators of financial fraud or financial distress (Luo et al., 2021). Therefore, through deep learning, MFI's can improve their credit scoring and identification of eligible borrower candidates for grant and facilitate an efficient lending process.

Adoption of AI by Financial Technology (FinTech) Companies

One of the main factors that contributed to the emergence of integration of AI credit scoring in the microfinance subsector is FinTech organizations that embrace AI to develop unique form of lending mechanisms. The FinTech enterprises have emerged as a threat to the conventional banking systems since they offer simple, efficient, and convenient financial services that are targeted towards the unserved population using different algorithms to conduct credit scoring (Gomber et al., 2017). These firms are now employing cloud computing, large data analysis, and blockchain to improve the loaning business and efficiency of borrower checks.

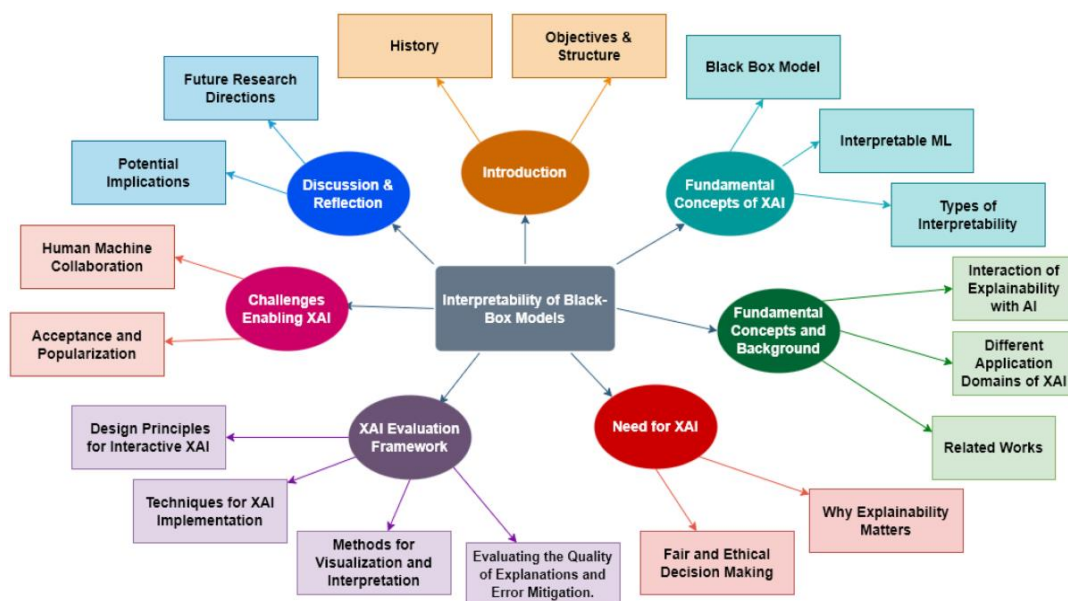
An example of the development is the usage of new generation AI-based digital lending applications that provide instant microcredit based on nontraditional credit information. Tala, Branch, Lenddo: Such firms employ artificial intelligence to assess credit risks by monitoring use of mobile phones, usage patterns and activities on the internet (Frost et al., 2019). These platforms have effectively opened financial possibilities in the developing economies where most organizations shy away from offering credit services because of high non-performing loans. The use of artificial intelligence credit scoring has enabled these FinTech firms to provide microloans with little paperwork and short turnaround time making credit accessible to those in the informal sector.

Figure 6: Alternative Credit Scoring by Machine Learning



Further, the use of AI in credit scoring has also led to integration of the use of explainable AI (XAI) to enhance transparency on the credit decisions made. Unlike the black box deep learning models, the XAI approaches offer more meaningful credit granting decisions by revealing the reasons behind approvals and declines (Doshi-Velez & Kim, 2017). This is an important development especially for the purpose of regulation of credit and to oversee fairness in credit delivery.

Figure 7: Interpretability of Black Box Models



Thus, it is expected that further cooperation between MFIs and FinTech companies in the use of artificial intelligence for credit scoring will spark increases within the sophistication and inclusiveness of lending. The application of Artificial Intelligence coupled with big data and financial technologies is rapidly transforming microfinance through the removal of credit risks, thus increasing the inclusion of the needy across the world.

3. AI Methodologies in Credit Scoring

This paper seeks to identify how the application of artificial intelligence in credit scoring has impacted on the microfinance institutions (MFIs). The past credit scoring models were based on omitted non-structured/non-financial data and efficiency, riddled with inconsistency, bias and partially, which excluded those who lacked credit history. Machine learning, in particular, has described much more prolific, versatile, and accurate credit scoring patterns of models AI based. These methodologies allow financial institutions to deal with structured and unstructured data, pattern identification, and improve the accuracy in evaluating default risks. Among the numerous methods used in the credit scoring analysis, including logistic regression, decision trees, and random forests, neural networks and deep learning, and SVM, the former two methods are considered the most effective and versatile.

Machine Learning Algorithms Used in Credit Scoring

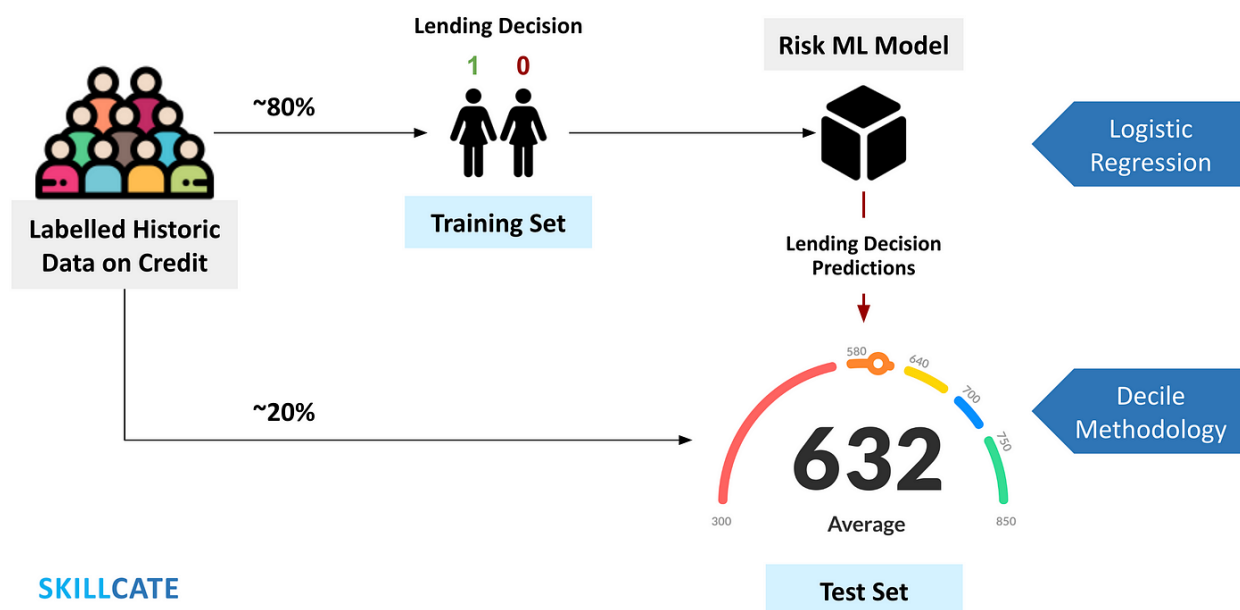
The use of artificial intelligence in credit risk analysis has assisted financial institutions to make more informed lending decisions by processing different variables. ML methods differ from rule-based scoring techniques and models that are based on fixed and predetermined equations in that they learn from new inputs. The use of such algorithms is of most use in microfinance because it allows the assessment of individuals who have a low credit score or who have no credit history at all. Every algorithm has its advantages and downsides; therefore, it is appropriate for particular segments of credit scoring and risk evaluation.

Logistic Regression

Logistic regression can be attributed as one of the oldest techniques that have been applied in credit scoring and is a fundamentally applied method of risk evaluation. It is particularly useful in binary classification exercises, for example, in predicting whether a borrower will be able to default on a loan or not (Maldonado et al., 2017). The logistic regression analysis sets out to explain the likelihood to default at some given level by defining the set of independent variables including income, debt to income ratio among others, previous repayment pattern. The results are then compared with a given criterion to determine whether applicants are in the low-risk or high-risk groups.

There are some key reasons why financial institutions often apply logistic regression as their method of choice: It is easy to understand and to interpret. It enables the lenders to quantify how each of the variables affects credit risk meaning that it will help the lending institution to explain the decisions made to the regulators as well as customers. However, logistic regression has a drawback of assuming that there is a linear relationship between independent variables and probability of default which might be limiting especially when working with complex non-linear financial data (Bańbura et al., 2019). Additionally, considering the fact that modern credit scoring systems are based on artificial intelligence, logistic regression becomes ineffective when applied to big data that contains high-dimensional and unstructured data.

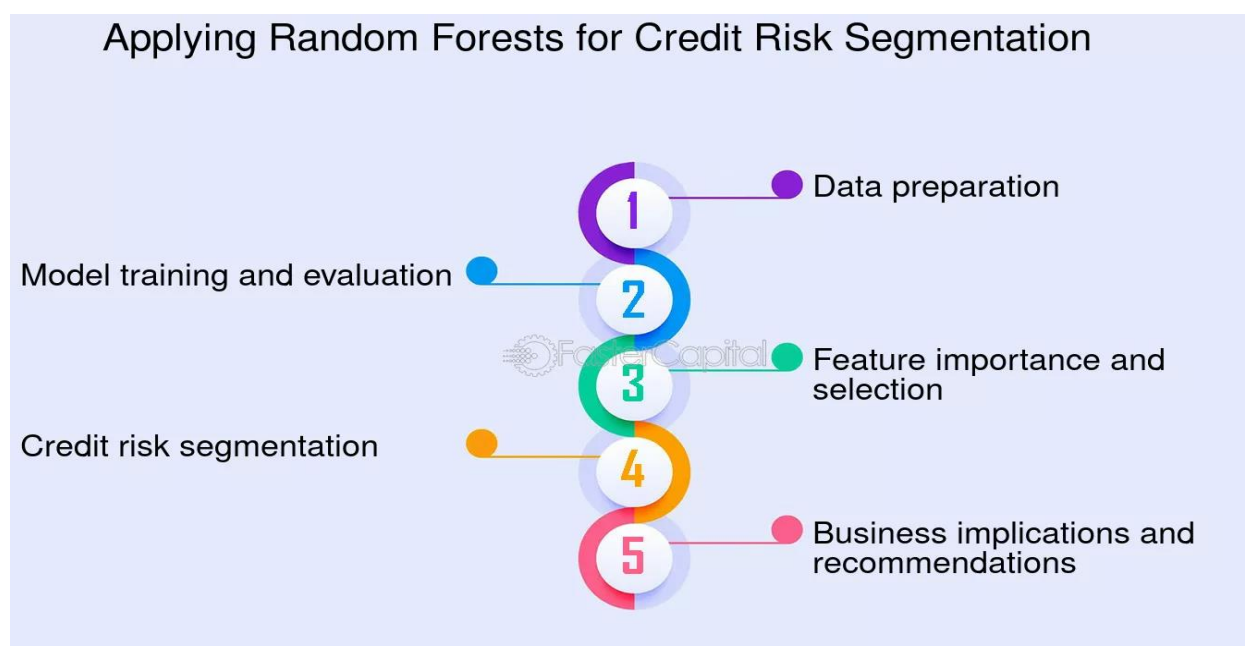
Figure 8: Logistic Regression



Decision Trees and Random Forests

In credit scoring decision trees are widely adopted due to the complex non-linear relationship between credit risk and borrowers' characteristics. According to a decision tree, data is divided into subsets by finding out the most important predictor variables. Each split then describes a separate decision rule which results in the borrower being categorised as creditworthy or high risk in the case of Riskowl (Zhang & Trivedi, 2021). Decision trees are fairly easy to explain and understand, and will enable microfinance institutions to explain their lending decisions more easily when using this credit scoring technique.

Figure 9: Applying Random Forests for Credit Segmentation



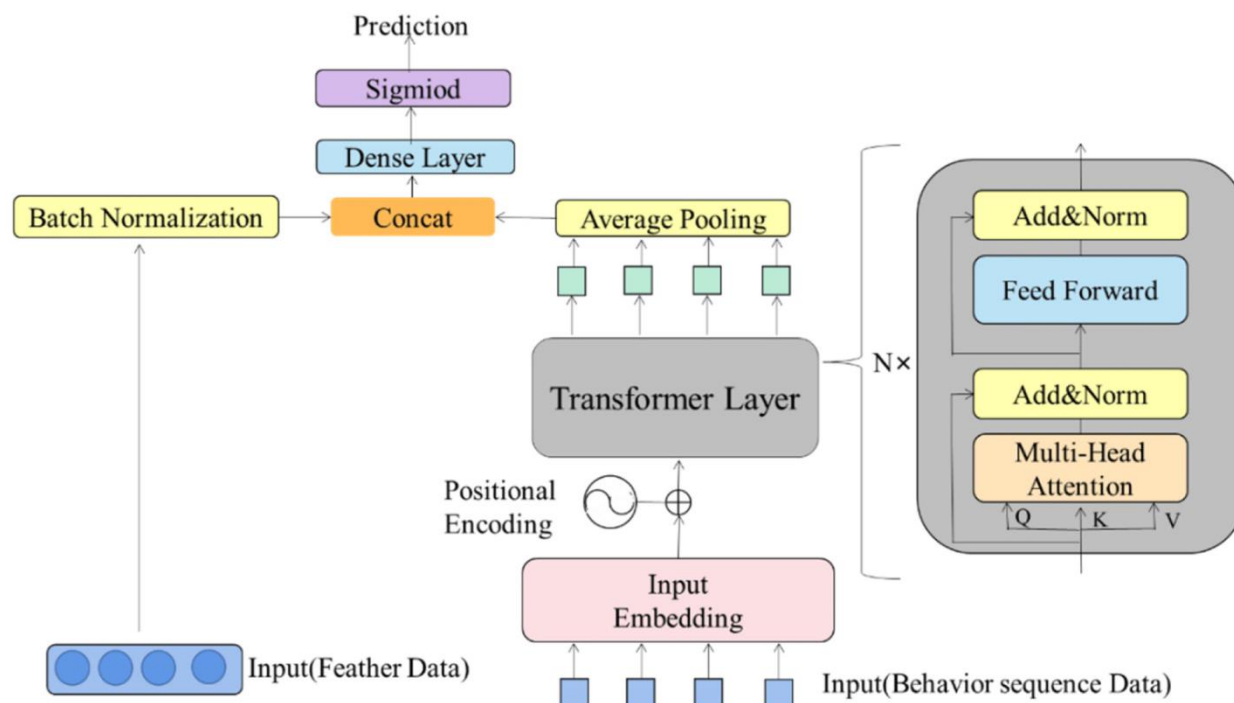
However, decision trees can be prone to over training and therefore perform well on the training set but poorly on the testing set. To overcome this limitation, other ensemble methods such as random forest models have been developed. Random forest is a type of algorithm that involves using a number of decision trees where each tree is grown on a different subset of the data set. An ensemble of trees in random forests decreases overfitting and increases the generalization performance due to the process of averaging the results (Breiman, 2001).

Random forests are useful in credit scoring applications since they are able to handle categorical as well as numerical data as well as work well with noisy data. The study also revealed that random forest models offer higher accuracy than logistic regression models for loan defaults especially when adopting ancillary data from features such as mobile transactions and social media activity (Lessmann et al., 2017). However, there are also some limitations in the adoption of random forests; these methods may be very computationally intensive and thus may have a high time and resource demand especially when the dataset is large in the microfinance system.

Neural Networks and Deep Learning

Artificial neural networks and deep learning score models have proved to be useful modeling techniques for credit scoring especially given the current availability of big data. However, deep learning techniques differ from most machine learning approaches in the sense that they do not require hand crafted features to be fed. They are employed layered architectures containing interconnected nodes that actively perform computations by successively producing representations from the given data (Yann LeCun et al., 2015).

Figure 10: Neural Networks and Deep Learning



Another strength concerning deep learning when used in credit scoring is its capability to deal with the huge or unstructured datasets, including text data within filled-in loan applications, transaction history, or linguistic and behavioral data from digital sources. CNNs are applied in image and scan

processing for borrower information; while RNNs in processing sequential data like borrowers' data on transactions being made over time (Goodfellow et al., 2016).

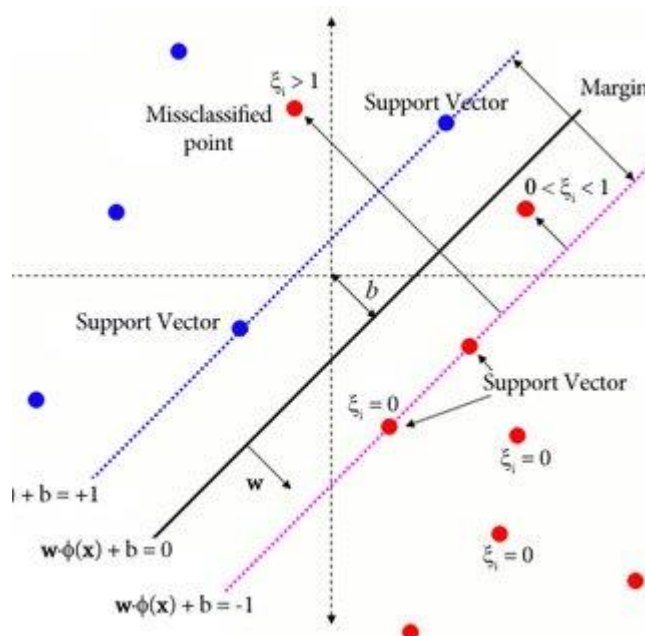
Machine learning models, especially Deep learning models have higher accuracy than the traditional credit scoring techniques. In a research article by Tsai and Wang (2019), using additional data sources, it was established that deep learning models provide improved classification accuracy than the basic logistic regression model and decision trees. But, one will agree that the big problem in neural networks is that many of the lending decisions they reach cannot be explained. This situation has caused concerns among the regulators and other financial institutions that demand for credibility in credit assessment.

To solve this problem, some methods have been proposed to extend techniques of Machine learning known as explainable artificial intelligence (XAI) to the credit scoring models based on deep learning. The post hoc methods like SHAP and LIME explain how loan authorization is arrived at in neural networks, thereby making the system more compliant with regulations in the microfinance sector (Ribeiro et al., 2016).

Support Vector Machines (SVM)

The second classification technique that is frequently used in credit scoring is support vector machines (SVM). SVMs operate by mapping data points on to a feature space to determine the best hyperplane that would separate data points based on given classes for instance credit worthy and risky borrowers (Cortes & Vapnik 1995). For one, while logistic regression makes a mere assumption that the independent variables and credit worthiness have a linear correlation, SVMs capture other unsuspected relations by use of kernels.

Figure 11: Support Vector Machines (SVM)



Another benefit of using SVMs in credit scoring is the ability to handle imbalanced data where there are significantly more non-default cases than default individuals which is the case in microfinance. It is, therefore, important to note that imbalanced data poses a key problem with

proportional and traditional classification models because of their bias. SVMs reduce this problem by finding the maximal margin of separation between different classes hence making the model to perform well with unseen data (Huang et al., 2007).

While they can provide prediction results that are very accurate, SVMs are computationally expensive and need to be fine-tuned in terms of parameter settings. They are less easy to interpret as compared to logistic regression and decision trees and are therefore difficult to apply in microfinances for organizations that need to be transparent. However, further development of the SVMs in features the framework that integrate the other Machine learning methodologies have been proposed to reduce the overfitting while maintaining the accuracy and interpretability in credit scoring problems (Wang et al., 2019).

Alternative Data Utilization in AI-Based Credit Scoring

As a result of advances in the field of artificial intelligence AI in credit scoring, the focus of risk assessment has been revolutionized in the financial industry. The conventional scoring executives used called for the historical behavior of repaying prior debts, income level and activities of the formal credit system. Though it has not been sufficient to determine the credit score of people with little or no credit history, especially those in developing countries and the microfinance segment. This makes the use of ADA as a tool for improving the existing AI-based credit scoring models due to the availability of unique insights into the borrowers' behavior and their creditworthiness. The new technologies of artificial intelligence now help evaluate credit worthiness and eligibility by incorporating social media activity, mobile phone usage, digital transaction records, biometric data, and psychometric tests.

Social Media Analysis for Behavioral Insights

Social networks act as open archives of user content, which exposes people's activity, communication, and decisions about their lives. Artificial intelligence-based credit scoring systems rely more and more on customer's social media behavior to obtain data about creditworthiness and responsibilities. Scholars have established that factors such as; reliability of the networks, the number of contacts, the language adopted in postings, and the sentiment analysis may hold valuable indicators for loan repayment status (Kumar & Ravi, 2021). With the help of social metrics it is possible to come to a decision about the solvency of borrowers taking into account the connections with others, the professional networking sites, and reputational standings.

Lenddo, a company in the financial technology space or FinTech as it is commonly referred, was among the first to establish novel credit scoring based on social media tracking which involved aspects of LinkedIn, Facebook and twitter pages of the users. Berg et al., (2020) has pointed out that people with constant and professional-like portrays online are more credible, especially in terms of their abilities to manage financial risks while those with sporadic online behaviors may pose risks. Likewise, using natural language processing, AI models of users' social media posts could also be used to predict emotional health and work conscientiousness, features associated with financial responsibility (Bjorkegren & Grissen, 2019).

Furthermore, AI credit scoring also uses machine learning methods to consider the frequency and the content of the contacts, the tie characteristics, and the engagement level. Previous works indicate that borrowers, who regularly connected with various employed contacts, updated their contacts more often and had positive online profiles, have low default rates (Djeundjie et al.,

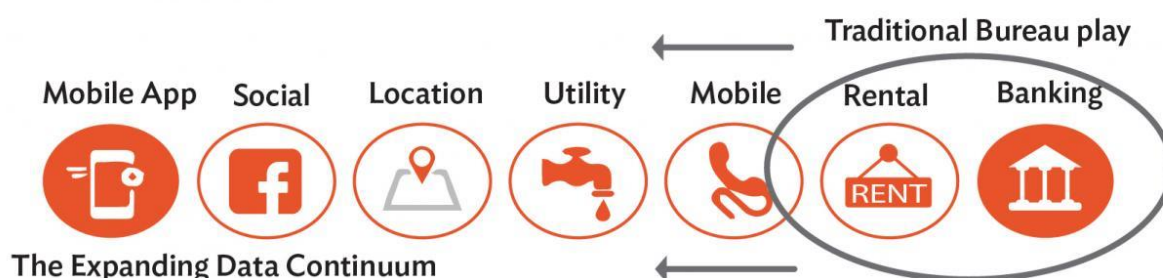
2021). Using social media together with other external data improves credit risk forecasts as social media helps in providing a scope of another client's financial discipline and stability.

However, like any other method of credit scoring, the use of social media data has its fair share of controversies. Data privacy and ownership, and the biases present in the algorithms themselves remain essential concerns (Pasquale, 2015). There is also a possibility that certain sections of the society will be overly afflicted by the algorithms as AI-driven models propagate bureaucracy and cause further enlargements of the pre existing gaps between the rich and the poor. There are increased concerns of social media in credit assessment across financial regulators because of the fairness that must be balanced by artificial intelligence use.

Mobile Phone Usage and Digital Transaction Data

As current consumer owned mobile phones especially in the developing countries, the data from the general mobile phone users is rich to facilitate credit scoring through the AI algorithms. The proposed analysis of the mobile phone activities such as number of calls made daily or text messages, amount of money spent on the pre-paid balance and money spent on applications, in fact provide clues on the borrowers' financial behavior. Cholleti et al. (2015) established that people potentially offering creditworthiness are those who use mobile phones daily, sustain contact lists, and use mobile payment services often.

Figure 12: Mobile Phone Usage and Digital Transaction Data



The AI-based credit scoring models also conduct financial stability evaluation by using call detail records. Behavioral factors derived from CDRs include, But let us not forget these parameters include the length of call duration, number of distinct connections and number of calls made to financial establishments or businesses. Singh et al., 2021 found that the borrower's written communication displays higher structure and more professional contacts EQUALS less defaults. Moreover, there is increased adoption of mobile phone credit scoring in microfinance because it can be used to rate borrowers who traditional banking cannot rate.

Applicable information such as mobile money transactions, e-wallet, and purchasing/ spending habits also improve the use of artificial intelligence in credit scoring. Some of the great FinTech solutions include Tala that use artificial intelligence to quickly and freely provide micro-loans to individual adult citizens with poor credit histories by analyzing their records on mobile money transactions (Jack & Suri, 2016). Thus, controlled and frequent uses of the send-receive payment, timely payments of bills, and other structured financing activities indicate better creditworthiness. Machine learning algorithms using historical transactions data can forecast the corresponding

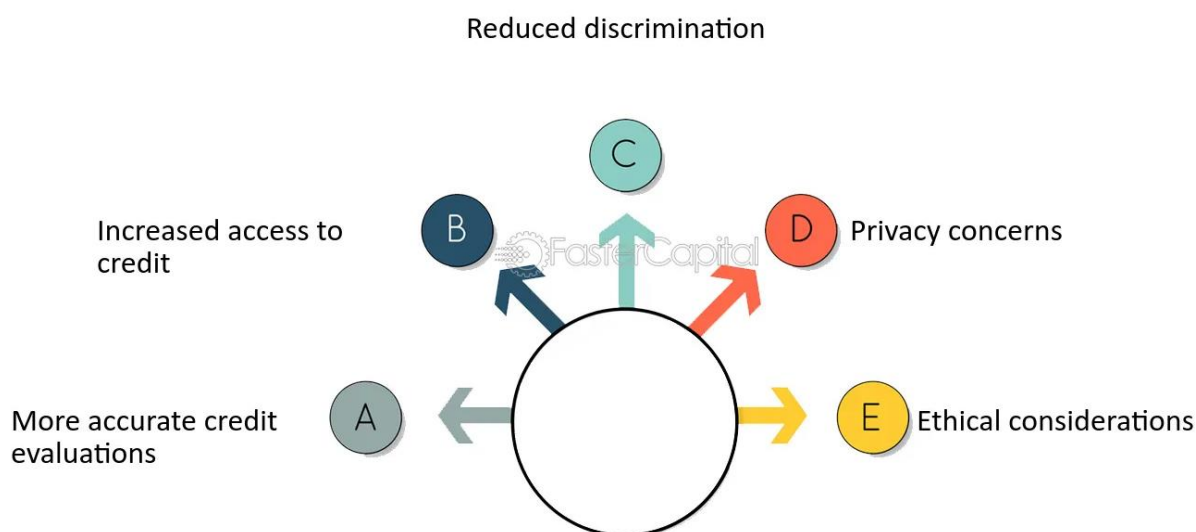
sending behaviours, cash flow steadiness, and financial rigidity and thus enhance risk assessment (Frost et al., 2019).

The use of digital transactions has been shown to be especially beneficial when used in credit scoring models in terms of financial inclusion. A paper by Chen and Faz (2021) identified that by integrating AI in mobile money credit scoring, more facilities to credit received by women and people in rural areas. Another advantage of using the AI models for underwriting based on the digital payments data is that the process gives a fairer credit score than the conventional scoring system that denies credit to individuals who don't have banking history. Nonetheless, some issues like data security, compliance to rules and regulations as well as inability of some people to use smartphones remain contentious issues.

Biometric and Psychometric Data for Creditworthiness Assessment

Fingerprint scans, facial recognition, and voice authentication have become common attributes used during the AI-based credit scoring. Biometrics provide an effective and fraudulent manner of ascertaining the identity of the borrowers especially in the developing world where documents such as passports are rare. The biometric system of authentication is quite efficient in making the financial systems secure from identity frauds thus ensuring that credit services are available to genuine and deserving borrowers only as posited by Gelb & Clark (2013).

Figure 13: How Psychometric Data Could Shape Creditworthiness Evaluation in the Future



Nowadays, biometric data are widely used by microfinance institutions to determine the creditworthiness of the applicant. Such as, Aadhaar biometric coins implemented has facilitated financial institutions to check identity of borrowers, their repayment history and even integrating Biometric Authentication into online lending platforms in India (Muralidharan et al., 2016). AI feeds using biometric data have also featured better results in aspects such as tackling loan frauds and detecting multiple loan applications. Furthermore, voice biometric technology has also been implemented in mobile banking for the application of loan facilities for borrowing, through the recognition of the borrower's voice (Muralidharan et al., 2019).

Another approach to credit scoring that has recently evolved is psychometric data which entails the measurement of an individual's personality characteristics, his/her decision making and his/her financial personalities amongst others. Psychometric credit assessment entails the use of questionnaires wherein borrowers respond to questions, which in turn determines their risk tolerance level, ability to self-regulate as well as financial planning ability (Klinger et al., 2013). High conscientiousness, as well as efficient financial planning skills are inherent characteristics that create lower default rates and psychometric information is indeed a potentially complementary source of data.

There are organizations, for instance, Entrepreneurial Finance Lab (EFL), which applied psychometric-based credit scoring to determine the creditworthiness of the owners of small businesses in the emerging markets. Research has revealed that psychometric tests increase credit access for credit constrained firm owners who though may lack necessary paperwork, but display positive ego depletion traits which dictate rational and proper usage of credit (Drexler et al., 2014). Combining psychometric data with other sources of data such as mobile transactions and social media results in a more complete credit score and hence better accuracy and a higher inclusion rate.

However, latest research has led to the use of biometric and psychometric data in credit scoring which has ethical and regulatory issues. Data collection and processing need to be in compliance with the privacy laws and regulations; the borrowers must give their consent to be indexed and have control over their identities (Acquisti et al., 2016). At the same time, there could be biases in the results of AI-driven psychometric assessments, and that could entail discrimination, so the models should be updated regularly, and ethical issues must be addressed.

AI-Driven Credit Scoring Models in Practice

The application of AI has been instrumental to credit scoring particularly to the microfinance organisations. Several studies have, for example, established that the use of advanced AI techniques such as machine learning algorithms and analytics to analyze biometric data, credit bureau data, and social media data have allowed lenders to extend credit to hitherto underbanked population. Status quo credit risk models have also been cited for failing in assessing credit rating of applicants who do not have normal formal records of finance records that include bank statements and credit histories. The above challenge has been tackled by bringing in behavioral, transactional, and digital footprints through the AI models to enhance the microfinance institutions' (MFIs) decision-making process in extending credits. Some of the case studies and real-life applications generally illustrate the application of AI in credit scoring and the effectiveness of risk evaluation in micro-financing in diverse settings.

Case Studies of Successful AI Implementation in Microfinance

A particularly relevant case study on AI credit scoring is the automation of the process in the Kenyan microfinance sector using machine learning. The mobile money services including the M-Pesa has grown very fast to offer a large volume of data of financial transactions that AI models use in evaluating credit risk. Johnson et al. (2018) also used an AI-based credit scoring model with the mobile money transaction history, airtime purchasing behavior, and bill payment behavior as the dataset to determine creditworthiness of borrowers. The results showed that by using the AI model, the non-performing loans can be reduced by 30% better than traditional credit scoring methods. It also revealed that those consumers who tend to use digital technologies often were

even more efficient in repaying the borrowed money, which proves the efficiency of alternative data sources in credit scoring.

One other example is the use of credit scoring with the help of AI in microfinance non-banking institutions based in India – CreditVidya. Subsequently, CreditVidya adopted a machine learning technique that addresses a broad spectrum of factual aspects that include mobile usage behavior, employment profile and history of transactions made online to determine the credit risk of first time borrowers. In their study, Sharma and Patel (2020) have clearly observed that CreditVidya was able to diversify its lending portfolio using the AI models and the organisation still has a below 5% default rate. The approach significantly improved the flexibility of the credit scoring system and helped the institution provide loans for the groups of borrowers that have a high risk according to conventional credit scoring, such as low-income households and freelancers.

Another study that was done was a comparative study with case evidence where the researcher investigated how artificial intelligence credit scoring worked in the Brazilian microfinance organisations. Rebel is the innovative fintech company that has designed the credit assessment tool that utilizes machine learning and psychometric and transactional data to assess the reliability of the borrower. As stated by Oliveira et al. (2019), it is possible to improve the performance of credit portfolios and also reduce the identified risks by adopting the AI model, which was able to predict the high-risk borrowers with 25% greater accuracy than the conventional models. This study showed the role of deploying additional alternative data including utility bill payments and online shopping for improving credit scoring for the microfinance clients.

These case studies show that the application of AI based credit scoring models has a significant effect on microfinance institutions as it makes right lending decisions, increases financial inclusion, and reduces credit risk among others. The penalties set by the government and the increased competition from Fintech innovation are making it possible for lenders to reach new untapped areas with quality and cost efficiency portfolios.

Examples of AI-Powered Credit Scoring Platforms

Several AI credit scoring solutions have been developed to stand out as innovative service providers within the Financial technology (FinTech) industry. It refers to those firms that apply AI systems, data management, and unconventional credit scoring to enhance people and SMEs' financial inclusion where they have no banking opportunities.

Lending credit scoring is another area where Lenddo is one of the flagships of AI, as it is able to use digital footprints and different types of data to measure the credit risk of a borrower. The platform generates credit scores for individuals who have no credit history by collecting as well as analyzing the behavioral and transactional data from social media interactions, mobile phone use, and application browsing. The study by Evans and Pirchio (2019) revealed that Lenddo has used an AI model to increase the number of people with access to funds in the emerging markets especially in Southeast Asia and Latin America. The study reveals that at Lenddo using credit assessment based on AI reduced the default rates by 22 percent and increased loans approvals by forty percent.

Another big player is the ZestFinance credit-scoring service that employs machine learning in the credit risk scoring task for lenders. ZestFinance uses thousands of features such as past employment and education and financial behavior to enhance the credit assessment model and provide higher accuracy in assessing the capability of the borrower to pay back the loan.

According to studies made by Huang and Yu (2021), application of artificial intelligence systems by ZestFinance increased approval rates of loans of financially vulnerable groups and decreased the level of defaults of the subprime borrowers. Risk characteristics of the clients were defined by ZestFinance models as more detailed and outperforming standard analytical approaches to establish credit scoring techniques.

Tala is another great example of the AI-based credit scoring which has brought innovations in the sphere of microfinance lending more specifically in Africa and Asia. Tala uses machine learning techniques to produce credit scores through its analyses on the use of the mobile phone, including SMS transactions, behaviour When users install and use apps on their mobile phones, and the usage of call logs which the firm analyses to provide credit scores because many people in the developing world are excluded from the formal banking system. According to Jack and Suri (2020), the use of AI credit assessment by Tala increased the financial access of more than 3 million previously excluded Kenyan citizens by offering microloans. The study also mentioned that the AI model of Tala enhanced the rates of loan repayment by fifteen percent and cuts down the operation cost of the lenders through the self-service credit assessment procedures.

Other AI-based credit scoring companies like Branch and Kiva, have also shown the effectiveness of the use of machine learning towards financial inclusion. Branch, an applications-based lending market offering lending services through individuals' mobile phones, leverages AI in credit scoring based on the data from individuals' smartphones, social media presence, and previous transactions. As much as independent research by Mckenzie & Paffhausen (2019) showed that Branch's AI model raised loan disbursement rates by 50%, it also established that default rates remained low. In the same way, Kiva, a microfinance company that makes use of an AI-enabled credit scoring system has effectively made peer-to-peer microlending possible for financially garish individuals.

The success of these credit scoring platforms which are underwritten by artificial intelligence points to the revolution that machine learning is bringing in microfinance. With the use of such factors as; about means that these platforms have allowed more borrowing to be done by citizens who cannot access finance from conventional institutions. The use of artificial intelligence in credit scoring has not only enhanced risk management and lending process but has also portrayed the positive aspect where many blacks and Latinos have been empowered economically.

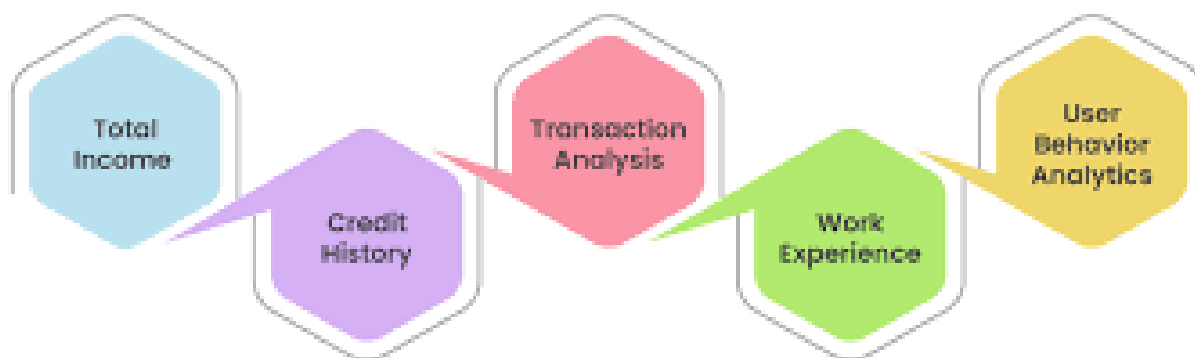
AI-based credit scoring has been beneficial in the branch of microfinance as it ensures better risk identification and creditworthiness assessment of the applicants. Examples from Kenya, India, and Brazil show how the use of AI analysis helps microfinance organizations to better evaluate credit risk, expand the possibility to receive credit for the population, and decrease the level of non-performing loans. Additionally, there are such AI-based credit scoring applications as Lenddo, ZestFinance, Tala, and others that apply machine learning to improve creditworthiness assessment for people with no financial background. AI has remained quite influential in credit scoring whereby many individuals and small businesses get a chance to get credit facilities. Some issues, such as data privacy, biased algorithms, and regulatory issues are still vital in the development of AI for credit assessment in the future. High degrees of transparency, more or less fairness, and implementing ethical issues in the lending sector will be critical as AI persists in marketing its merits in microfinance.

4. Impact of AI-Based Credit Scoring on Microfinance

AI has eventually revolutionized the concept of microfinance through credit scoring and changed the method of risk assessment of borrowers and credit delivery. According to the traditional credit scoring methods, millions of people have been locked out of the credit system as they do not have any record with the banks. This has been more so the case especially in the emerging markets as a high percentage of the population remains financially excluded. This has seen the development of a new credit scoring system that utilizes artificial intelligence to incorporate sources of information, advanced algorithms as well as automation to improve the availability of credit and credit assessment. Innovatively, using Artificial Intelligence to advance microfinance is most significant in minimizing the denial rate of credit facilities to unbanked and quickening the grant of credit facilities to the populace.

Figure 14: AI-Based Credit Scoring Decisions

AI-based credit scoring decisions are formed from data such as:



Enhancing Loan Accessibility

The revolutionary effect of AI credit scoring is the opening of major opportunities to lend to persons who never could qualify for credit based on conventional risk evaluation methods. The traditional credit risk assessment techniques depend on particularized socio-economic information, Balance sheets, pay stubs and credit history. Still, millions of people, especially, the inhabitants of the developing countries, cannot use the services of the financial institutions and have no documents necessary to obtain a conventional loan (Demirgüç-Kunt et al., 2018). This has not been made possible through AI-powered credit assessment, which uses data from the Internet and mobile phone usage, e-commerce activities, utility bills, and borrowers' behaviors among others to provide more fair and accurate credit risk assessment.

Peria and Singh (2020) owe it to the adoption of the AI credit-scoring models to enhance the efficiency of microfinance institutions, where they recorded a 35% improvement in the first time borrowers' loan approvals. It also brought to light the fact that there were a lot of applicants who had been considered "high-risk" in conventional risk-assessing methodology but obtained loans because of their behavioral patterns that were collected and interpreted by the AI model. Thus, with the help of such ML algorithms, financial institutions would likely be able to detect positive

credit-related behaviors like, regular mobile phone credit top-ups, punctual payment of utility bills or stable employment even if a credit profile was not available.

Credit scoring models based on artificial intelligence has also helped to open the credit market to women and rural businessmen who for so many years cannot have a credit facility. Ashta and Fall (2021) explored the effects of AI-based lending platforms on female entrepreneurs in sub-Saharan Africa and identified that, with the help of AI in credit scoring, the number of loan approvals for women-owned businesses enhanced by 27 percent. The study also observed that the AI models used in the study was able to determine the ability of female borrowers to pay based on mobile interaction, business cash flow, and social network activities. The authors said that the use of AI in credit scoring was decisive in ending the exclusion of women businessmen from funds that they require to expand their companies.

Moreover, credit scoring whereby the use of artificial intelligence has also been particularly useful when addressing the needs of people residing in rural areas as the number of credit unions is not very high in such regions. As the availability of traditional bank-related resources is limited in many regions, proper lending services based on AI are logical. Bazarbash et al (2019) revealed through the study that, by leveraging on mobile money transactions, AI credit assessment models in east Africa advanced micro loan disbursements to the borrowers in the rural areas by 40%. The study also revealed that once consumers are underpinned by an appropriate conduit of mobile payment association linked with their other associated digital transactions, they are able to borrow credit even if they cannot hold banking affiliations. Due to the integration of AI into the various other types of data, most of the financially excluded population is now able to find a place in the credit system.

Reduction in Loan Rejection Rates for the Unbanked Population

Loan rejection rates have remained very high among the unbanked because conventional lenders use credos of credit evaluation that they do not consider the unbanked. This has been information technology solved by credit scoring models that has upgraded the risk rating and discovered feasible risk takers who would otherwise be rejected through the conventional scoring systems. Frost, W. et al., (2021) further reveal that the current AI credit modeling for credit scoring in Latin America has helped lending institutions bring down the loan rejection trend by a third while at the same time, ensuring portfolio stability. This decline was ascribed to the possibility of using AI models in knowing the behavioral and transactional pattern which helps the financial institutions to distinguish between the high risk and low risk customers.

Since AI-implemented credit assessment works with a large amount of data processed in real-time, creditworthy borrowers not fitting textbook definitions of creditworthiness can be identified. In a study by Khandani et al. (2020), the authors established that, it is possible to use AI with social media data, e-commerce transactions, and the digital payments records to estimate borrower reliability by a 25% higher accuracy than conventional credit scoring. This has helped to reduce rejections of unbanked people as the credit providers are in a position to analyze borrower's information in detail.

Furthermore, the incorporation of AI into credit scoring has also lessened rejection on loan applications from micro, small, and medium enterprises through digital credit scoring which are otherwise difficult and costly to get access to main credit sources owing to the inadequacy of conventional documents. According to Ghosh and Roy (2022), by analyzing the effects of credit

assessment done through Artificial intelligence on lending to small businesses in Southeast Asia was carried out to reveal that the loan approval rates improved by 28% for the MSMEs once they adopted the AI risk evaluation models. The researchers pointed out that due to the availability of real-time data on business transactions and online sales, supplier payments, more favorable loan performances can be expected by lenders using artificial intelligence.

Despite these, there are potential issues in how the alternative credit scoring system through AI affects loan rejection rates and how much it can bias the scores given to the applicants. There are questions about algorithmic bias; it is a possibility that if AI is taught with prejudiced data, then it will only exacerbate the existing inequalities regarding finances. For instance, Barocas et al. (2019) has insisted on the significance of regulation and disclosure of AI credit risk analytics with the aim of preventing a situation where these technologies lock out specific population groups. The effectiveness of these areas will be relevant to the achievement of the right formula in applying artificial intelligence to lending while at the same time providing a sound lending culture.

Faster and Automated Loan Approval Processes

Another kind of effect, which arises from the integration of the AI in the microlending model, is the speeding up of loan processing activities. A traditional credit assessment involves assessing the borrower through paperwork, time-consuming and face-to-face interviews, thus in a world that time is of the essence, it increases the amount of time taken to access credit a blow to those in dire need of credit. Applying credit scoring models has also shortened the time taken in contracting and lending by providing real-time scoring of the risks.

Philippon (2021) analyzed the impact of AI in lending companies in Europe and concluded that the time it took to process the loans has been cut by a mean of 65% with the use of machine learning credit scoring. One of the significant findings of the study was that using AI models, the firms pointed out that it would take less than a few minutes to process the applications since the borrower data were analyzed in real-time, leading to efficient approval of funds for disbursement. This has been very helpful especially to the microfinance clients who need money for prompt expenditures such as business purposes, medical bills or anything which they hadn't anticipated.

Self-approval of loans, which have adopted the use of artificial intelligence have also helped in cutting costs among the lenders. According to the study conducted by, McWaters et al. (2020) revealed that the organization that adopted the application of AI in credit assessment had a 40% reduction in the administrative cost of managing loans. Due to reduction of human intervention in the approval process and the improved operations of the microfinance sector, the clients have benefited from the use of artificial intelligence.

Further, there are some examples: Tala and Branch are the AI-powered lending platforms which prove the efficiency of the real-time credit scoring in emerging markets. These platforms thus rely on the use of a mobile phone database and transaction history analysis of the borrower to approve loans instantly without collateral or even identification documents. According to Gomber et al. (2022), through deploying the AI digital lending platforms, it had a shortening of loan disbursal time from days to minutes; which enhanced financial access for those in low income brackets.

Enhancing Risk Appraisal and Credit Decisions

The application of AI in credit scoring has improved the efficiency of credit risk assessment in the financial sectors especially the microfinance institutions by increasing the rates of lending with the

least risks. Prior credit scorecards primarily based their credit ratings on features such as the borrowers' past financials, which were not effective in determining the creditworthiness of individuals who are not documented by conventional banks. Such conventional measures were usually ineffective in capturing these indicators in the manner of individuals conducting their financial operations with the informal markets. AI in credit scoring involves using artificial intelligence and big data and has contributed to more realistic credit risk assessments coupled with real-time fraud detections. Effectively applying a large amount of structured and unstructured data, AI has introduced improvements of microfinance activities of lenders, decreasing of default rate and increasing overall stability in the sphere.

AI's Efficiency in Identifying Facilities with Potential Credit Risk

The ability to combine more and less credit-worthy observations and unravel U-shaped as well as any other complex structure of changing relations between financial behaviors and loan repayment probabilities are the main advantages of AI in credit risk assessment. Conventional approaches like the logistic regression method and the linear credit scoring approaches do not provide a more comprehensive business risk by focusing on borrowed funds alone and referring to the past AGERE relations as the potential evidence of the customers' future creditworthiness. However, AI-based models apply new machine learning techniques, deep learning, decision trees and neural networks to detect the borrower data features that are not easily understandable by conventional models as stated by (Chen et al., 2020). These AI models also give the lenders sound credit risk assessment and ensure they give loans to responsible borrowers who may not have formal credit histories.

In the COVID 19 context, a study done by Bhatia et al. (2021) revealed that the employment of AI based credit risk prediction models outperforms the statistical models and prediction error in loan defaults. The study also looked into samples from microfinance borrowers in Southeast Asia and proved that AI algorithms could reduce false negative classifications (wrongly flagging a borrower as high risk) by 27% compared to other approaches. The study pointed out that through using the data pattern from the customers' behavior from features such as the use of the mobile phones, their payment habits, and even utilization of GPS, the AI algorithms were capable of determining the financial solvency of the borrower. It helps the lenders to grant credit to those individuals who would be out of the credit scoring range while at the same time ensuring that they limit the risks of default.

Another benefit of the use of AI in credit risk evaluation is the incorporation of the latest financial tests into the models used in evaluating the credit risks. This is unlike the conventional credit scoring that involves analysis of historical credit data; things such as credit score and balance, credit utilization ratio among other factors; with new data on the buyer's transactions, spending, and repayment profile refreshing the risk analysis every time. Gupta and Malhotra (2022) have revealed that, due to availability of real-time financial data fed into the score cards, credit scorers based on nodes of artificial intelligence had 34% higher predictive power to detect changes in borrower risk characteristics. Thus, a dynamic risk assessment procedure allows the lenders to identify the likely defaulters and protect against such risks before they happen.

AI models also have been utilized most notably in credit scoring of small business and micro-entrepreneurs who do not usually possess conventional statements. Rodríguez and Fernández (2020) had specifically focused on credit scoring of the micro-enterprise using AI in Latin America and discovered that advancing AI models using business cash flow, supplier payments data along with the customer transaction histories highlighted the improvement of around 41% of

the loan accuracy. The study also pointed out that due to the real-time assessment of the overall health of businesses, the lending risks to the micro finance institutions were well contained while the otherwise underbanked received the credit facilities that they needed.

Nonetheless, there are gaps concerning the utilization of AI in credit risk assessment with relation to the level of transparency of the AI algorithms. Some of the AI driven models work in a 'black box' form, whereby lenders or regulators can not understand how the mathematical models make those decisions. This lack of information disclosure is rather problematic and leads to doubts regarding possible biases in lending choices. In order to combat this, scholars have suggested that XAI should be implemented to offer clarification on how AI evaluates borrower risk (Lipton 2018). The integration of XAI in credit scoring allows lenders to determine whether the AI-based decision-making process is correct and comprehensible, enhancing people's trust in AI-based lending systems.

Real-Time Fraud Detection and Prevention Mechanisms

Besides the enhancement of credit profiles, AI has been effective in the detection of frauds in microfinance lending. Among the many threats, fraudulent loan applications, identity theft, and other types of financial fraud have always remained prominent, resulting in tremendous losses and low levels of confidence in the lending system. The application of AI and ML makes it possible for lenders to detect any fraudulent activities by the borrowers by using patterns and anomaly detection approaches.

Anomaly detection is among the most efficient AI approaches in fraud detection, it being centered on evaluations of what Borrowers do not normally Do. The AI models consider the transaction records, repayment history, spending frequency, and other such characteristics, to build up a data set basal to 'normal' behavior. When the behavior regarding the application or a transaction looks suspicious and deviates from the normal pattern, for example, where an applicant demands a large loan, the data of the borrower is inconsistent, or the behavior pattern changes drastically and suddenly the AI model sets it aside for investigation (Nguyen et al., 2021). Financial fraud has been, therefore, drastically curbed in the contemporary microfinance lending through efficient detection of these compromises.

In a study that was conducted by Li et al. (2022) on the effectiveness of AI in combating fraud in the digital loan lending industry in Africa, it was found that AI solutions in mitigating fraud prevented the approval of fraudulent loans by 38%. The study showed that when machine learning was trained on previously identified data patterns of fraud, synthetic identity fraud which is a category of fraud that involves creation of fake borrowers using stolen details was well identified with high accuracy. Through observing irregularities relating to loan applications, AI was indeed able to detect and avoid cases of fraud in the disbursement of loans whereby the institution could have incurred losses.

Others include; Natural Language Processing which is used in handling textual content in loan applications and communication with customers that may involve fraudulent activities. In particular, the NLP algorithms can be employed in AI models to determine which of the applicants are most likely to bring about fraudulent statements regarding their financial or employment history. Zhang and Wang, 2021 realized that the efficiency of the NLP-based fraud detection systems decreased the cases of fraud in the micro finance institutions of Asia by 29%. That way,

the study pointed out that there are certain linguistic markers even users of fake IDs cannot hide that will enable lenders to investigate their backgrounds better before extending credit.

AI has also helped microfinance lending to improve on the biometric fraud prevention system. Other biometric measures including facial, fingerprint and voice recognition are used to check the identity of the borrowers to avoid cases of identity theft. Choudhury et al.(2020) conducted a study on the use of AI linked biometric authentication in micro-finance institutions in India and pointed out that the usage of the AI-based biometric verification system has decreased cases of identity fraud by 46 percent. The study highlighted that there are possibilities of preventing deepfake and synthetic identity fraud by monitoring and evaluating micro expressions, voice intonations, as well as fingerprints. Consequently, biometrics authentication has enhanced the play of security measures in the outcome of AI digital lending platforms and enhanced integrity of micro finance transactions.

While AI has a great value in fraud detection, there are some issues related to data protection and ethical practices regarding borrower data. Online fraud mitigation by way of using artificial intelligence entails the use of personal and financial details, therefore it raises issues of privacy and security of borrowers. Concisely, Raji et al., 2021 has highlighted the policies that should be put in place and adherence to regulatory requirements in order to check the use of borrower information by third parties. This particular challenge shows that in the future, AI-driven fraud prevention will remain paramount and the ability to maintain the balance between security and privacy will have to be met in order to enable the use of AI-based lending systems .

Promoting Financial Inclusion

The drive for financial inclusion has increased due to the fact that millions of people and small businesses around the world and especially in the developing countries are unable to avail the formal banking services. Individuals require credit, savings, and insurance so that they can engage in small businesses and save, yet many people do not have access to these basic needs because of factors like credit history, geographical location and racism, among others. AI has proved to be a solution to this by coming up with effective approaches on the determination of credit rating, risk management and provision of financial services to the omitted people. As will be discussed in detail subsequently, AI has been especially beneficial in handling traditional challenges to lending like the utilization of other data as well as the automation of procedures and the modulation of effective products. Conversely, with AI regarding gender, it has been assisting in enhancing gender-sensitive financial services to pave the way in availing credit and economic opportunities to women.

Among of the most felt impacts, AI is playing a critical role of solving the challenges of credit invisibility, which entails low-income earners, informal employees, and the rural folks. The use of conventional credit scoring approaches incorporating data obtained from the financial institutions discriminates against those who are outside the banked population. Traditional credit scoring models have evolved and opened up the scoring models with the help of the seven pillars such as the usage of mobile phone bills, payment of utility bills, online transactions, and social media activity to evaluate the credit worthiness of the individual (Miller, 2020). With the use of such numerous boosters of credit scoring, AI helps the financial institutions issue credit to those who, according to traditional credit scoring system, are considered ineligible for loans.

In another paper by Agarwal et al, (2021) a study was done where it was revealed that through the use of AI in credit assessment in the Southeast Asia region, approval rates for loans was higher among those that were previously unable to access credit by 42%. The research pointed out that since AI could handle other data types, it helped the lenders to extend credit even to borrowers who could not provide conventional records. Specifically, the research identified that people with normal main behaviors of mobile payment and stable consumption behaviors would get higher possibility of being approved for a micro loan. This implies that AI can achieve what was hitherto thought to be impossible by categorizing the rights to make a distinction between risky non-borrowers and the defaulting ones from the rest of the population of credit seekers.

Another advantage of AI in financial inclusion is that it allows lending platforms to operate in the areas where there are few branches of banks. As for many of the rural areas and other unserved places, conventional physical branches in the banking systems are limited, and hence people cannot easily access their banking needs. Mobile loan apps such as Tala and Branch have filled this gap by offering mobile loans that are processed by analyzing the data resulting from mobile transactions and electronic footprints (Chen & Rachmawati, 2022). It's not a secret that online payment platforms are particularly popular in Africa and South Asia where the penetration of mobile telecommunication is very high but the penetration of banking services is incomplete. Onyema et al. (2021) indicated that a survey of utilization rates and effectiveness of AI-based mobile lending showed that it increased by 60% borrowers' accessibility credit for small business owners in sub-Saharan Africa; this shows how AI aids in the reach of potential users in the provision of financial services in remote or zonal areas.

Further, AI has benefited financial literacy programs enabling the use of appropriate knowledge in decision making on matters relating to finances. The use of chatbots and other artificial intelligence-based financial applications in lending has aimed at informing borrowers on credit, save money, and loan repayment plans. Such solutions include using an algorithm to suggest a course of action based on the person's behavior to provide the best and unique advice that low-caliber borrowers can benefit from (Sundaram & Kim, 2021). These interventions have been especially useful in enhancing the repayment of some of the loans and curtailing on foreclosure as the borrowers get to understand their roles and responsibilities.

The Role of AI in Gender-Inclusive Financial Services

Women have been financially excluded due to several factors, especially when they live in worlds where they are dominated by their male counterparts. The Global Findex Database by the World Bank shows that women are even more locked out from the financial sector, as revealed from the trends in credit and savings and financial literacy (Demirgüç-Kunt et al., 2021). AI has been very instrumental in helping to tackle such issues by providing gender-sensitive, suitably targeted financial services to the female market.

Probably one of the greatest contributions of AI in gender-inclusive finance has been the emergence of use scorecards where the credit worthiness of women can be evaluated through behavioral and transactional patterns rather than ensuring or employment records. A number of women in developing economies cannot provide collateral and formal employment, hence they cannot get loans via conventional banking. AI models, though, have helped the lenders to accredit the female borrowers by their digital transactions, small-scale business operations, and social media interactions for extending the credit facilities to women without facing the conventional formalities of documentation (Banerjee et al., 2022).

A study by Rojas and López in 2021 confirmed that the funding that spate resulted from the use of AI in lending resulted in an increase of approval for women entrepreneurs by 35 percent in South America. The study showed that the use of various sources of data including online revenue transactions, movements on mobile money and e-commerce activities helped facilitate credit lending to women who otherwise would not qualify for the loan according to conventional risk factors through the use of AI. This has also promoted women's economic exploitation in that most of them have gained access to credit facilities needed to run their business, educate their children as well as increase their household bargaining capacity.

In addition, the modernization of the banking industry through the help of artificial intelligence offers more control to women over their money. In most of the developing nations, the traditional norms and practices essentially deny women the right to open a bank account or participate in financial businesses on their own. This development has been helped by innovations such a Mobile banking application that has enabled the women to manage their financial matters via their mobile phones. Other studies by Akinola and Osei (2022) also showed that the use of AI in the delivery of financial services in West Africa helped in enhancing the level of financial engagement among women by 47 percent, thus suggesting a possibility of eradicating the financial gender divide through AI.

AI has also played a part in diminishing instances of bias in credit rating with regard to the gender of the applicant. The traditional lending practices have been proven to impose discrimination towards the female gender by either Geocoding women lower than their male counterparts or by posing higher collateral demands on the women. It is for this reason that AI credit assessment models have been developed to counter and eradicate these types of prejudices as they are based on facts as opposed to intuition. Some studies have proved that gender similar models created from gender-neutral data accurately do the intended provisions fairly to the female clients without prejudice judging their behaviors discriminately (Doss et al., 2021).

One of the more composite effects of AI in gender-inclusive finance is in microfinance institutions with emphasis on women entrepreneurs. Micro financing has been able to expand through the help of artificial intelligence when it comes to loan underwriting as this has helped cut down on the amount of time and money spent on the evaluations of credit reports. According to another research done by Krishnan and Subramanian in 2021 revealed that by applying artificial intelligence into microfinance, 55% of loans for women entrepreneurs have been disbursed in SA.

5. Challenges in AI-Based Credit Scoring

With the increased uptake in the use of artificial intelligence in credit scoring it has become easier for institutions especially those in microfinance to evaluate the credit risk of borrowers. In the financial sector, AI has improved financial access, particularly for those who had been locked out of banking services, and has improved credit risk models' reliability and cut down on the rates of loan declines. Nevertheless, the use of AI in credit scoring has some issues to deal with to become effective and ethical successfully. The challenges it presents are data privacy and security, algorithmic bias and fairness, regulations and ethics, and compatibility issues of MFIs. These are key factors that must be managed and overcome in order to demonstrate consistently sustainable success in relation to the AI driven lending systems.

Data Privacy and Security Concerns

The problem arises on how personal and financial information has to be collected, stored, and most importantly secured when creating an AI-based credit scoring model. Sota AI models for assessing borrower risk use various forms of data gathered in large quantities and also includes non-traditional types of data such as mobile phone usage, social media, and purchasing patterns. As with other forms of big data that supplement credit risk evaluation, the former also has certain risks tied to data privacy and protection. There's lack of awareness of how the borrower's data is collected and used, thus raising concerns on informed consent and use of data (Tene & Polonetsky, 2022). The discussion about the ethical issue stems from the increase in the use of AI credit assessment in which personal and scale data is collected and processed without user consent of the borrowers.

It not only must focus on the AI credit score for a financial institution but also on another level, security concerns because data leaks are critical risks for both sides, lenders, and borrowers. Financial institutions are now a popular choice for cybercriminals who seek the information of borrowers, giving them access to their personal data and, consequently, different forms of identity theft and fraud (Tankard, 2021). This is especially so given the fact that most microfinance clients lack legal safeguards and remedies that are found in organized microfinance systems as compared to conventional credit systems. Mukhopadhyay et al. (2023) identified that when an organization is involved in the use of AI in the lending field, there is a significant risk as most of the records are now found online or arranged with the use of cloud storage and this makes them an easy target for hackers. The study called for proper frameworks, open encryption systems to be implemented as well as constant monitoring of the AI-based lending models to prevent the mentioned risks.

Adding to the problem of data privacy is the challenge of regulations because financial institutions are subjected to changing legal requirements of data protection. Laws including the General Data Protection Regulation in the European Union and respective laws in other regions set high standards of personal information processing. The institutions having their branches across different countries face many and at times mixed rules and regulations areas, which makes operations complicated (Kuner, Most, Tugster, & Zhang, 2022). In a case where there is limited regulation, there are likely to be problems with the use of borrowers' data by AI lending models. The key issue that has been emerging in implementing the credit scoring model in the finance industry is preserv-ing global data protection standards to get and retaining operational efficiency.

Algorithmic Bias and Fairness Issues

Credit scoring technology based on artificial intelligence has been brought under criticism for the reinforcement of bias principles which were present in the previous financial models of credit rating. Bias in AI models can be of three types, the training data which is selected, the features chosen, and algorithmic bias where a model can intentionally or unintentionally discriminate against some class of users or individuals. With regards to bias, it is learned directly from data therefore, if the data used is biased towards existing discriminatory lending practices, the AI system created is also bound to be discriminative (Barocas et al., 2021). For instance, if there was preceding data of loan rejections to women or minority applicants, an AI algorithm trained on such data shall reflect the same biased performance in the future.

Discriminatory prejudice has been specifically discussed in the literature on equal distribution of credit through financing technologically advanced solutions. Cowgill et al., (2022) revealed that gender and SES bias was present in the AI credit assessment models employed by digital lenders. The paper showed that despite exhibiting sound behaviours, individuals with a lower credit

standing were categorized into higher risk groups. For instance, according to Obermeyer et al. (2022), racial bias was introduced in the credit risk models powered by artificial intelligence resulting in high interests, and other requirements limiting loan access to those of color. Thus, the presented research results evidence the need for further policy-making aimed at dealing with the fairness problems in AI-based lending.

Bias in AI models can be reduced by using fairness in machine learning, providing a more diverse set of training data, and using a technique called XAI or explainable AI. AI models for fairness ensure that bias in the lending process is identified and methods to control and alter lending decisions to conform to equal opportunities. An example of such debiasing approaches recommended by Mehrabi et al. (2022) include methods that train machines to reduce the effects of the bias that may be within the feature set without any compromise to the model's predictive capability. Also, the credit institutions should guarantee that the algorithms applied by them for the AI are checked frequently and for bias in the credit reporting process. Some techniques of explaining realized AI can also enhance fairness, by giving borrowers insight into how AI works and how they can appeal unjustified negative credit decisions.

Regulatory and Ethical Considerations

The implementation and usage of credit scoring using artificial intelligence has triggered concerns such as ethical and regulatory concerns on the decisions made, and whether it meets the necessary financial regulations to govern it. In contrast to conventional credit-scoring techniques, which are stereotyped on specific metrics that may be easily checked by auditors, most AI models remain inscrutable which makes it challenging for regulators as well as borrowers to know the rationale behind lending decisions (Binns et al., 2022). One of the key issues for financial institutions is the non-transparency of the AI decisions to provide loans and credit facilities since decision making is a very sensitive process and financial institutions are expected to be accountable in their decisions to lend out money.

The importance of non-tainted AI policy decisions has therefore been recognized by regulatory authorities across every corner of the globe. The governments and financial regulators have also demanded that the machine learning credit scoring systems should be transparent, traceable and non-discriminatory. The EBA has called for AI used in loans to explain their decisions and allow the borrowers to appeal for non-approval of credit offers (Russell & Bohannon, 2023). In the same manner, the US and Asian financial departments have established policies aimed at the ethical utilization of AI in the finance field.

Various financial regulations and ethical practice on AI brings the need for well-grounded governance structures for lending through AI in financial institutions. It is necessary to create reference ethical AI committees, using internal audit practices, and guarantee that AI models are aligned with the novel benchmarks for fairness and risk management (Rahwan et al., 2022). Furthermore, regulatory sandboxes have been suggested to be a model to apply AI credit scoring before its implementation in financial organizations with the presence of supervisors.

Integration Challenges for Microfinance Institutions

There are several issues that arise when AI credit scoring is used in MFIs, including cost implications, infrastructure, and sourcing of technical personnel. A good number of MFIs work under conditions of restricted resources, including the availability of sophisticated computing systems, cloud solutions, and fast and efficient internet connections. Using AI-based credit scoring

models consumes a large amount of technological resources, especially when it comes to microfinance lenders, which might be beyond their means (Ghosh et al., 2023). Lack of capital, including cost outlay for procuring the AI software, training of staff to inculcate the use of AI and the recurring costs in maintaining such platforms puts a constraint on the ability of MFIs to expand the use of AI.

The last but not the least is technical know-how that remains a major challenge for the implementation of AI in microfinance. Use of AI in credit scoring entails understanding of machine learning, data and algorithms which are rare among most microfinance institutions. In the study conducted by Ahmad et al. (2023), the findings revealed that 74% of microfinance institutions in developing nations indicated they had no competent personnel in AI implementation and management of the credit assessment models that have an AI influence. Therefore, financial institutions need to incorporate the training of AI and work with key technology players to enhance the development of AI systems.

However, the opportunities of AI-based credit scoring are significant to microfinance as it can increase the number of people with access to credit, enhance credit risk evaluation, and decrease numerous expenses. Overcoming data privacy issues, bias, regulatory challenges, and artificial intelligence challenges will go a long way in ensuring that the AI in lending systems is equal, straightforward, and open to all individuals.

6. Future Directions and Recommendations

The advancement in the application of artificial intelligence in the credit scoring system has particularly impacted positively on the financial industry especially the micro finance companies. Artificial intelligence in credit scoring has been shown to have benefits in terms of increasing access to credit, as well as a more accurate evaluation of borrowers' creditworthiness and automation of credit decisions. However, there are still some limitations of using AI in the political process, such as transparency issues, bias, compliance, and security issues. Therefore, it is necessary to identify the future trends and outline the recommendations that would permit the ethical and efficient use of AI technologies in credit scoring. The future trends in AI for credit scoring need to ensure the use of modern AI techniques, use of XAI, need well-developed policy and regulatory structure, as well as develop strategies regarding fairness and data security. The suggested steps will play a significant role in promoting ethically sound AI-based lending services for both lenders and borrowers.

Advancements in AI for Credit Scoring

Artificial Intelligence is still advancing at a very fast pace and is introducing new methods to improve the estimation of risks, efficiency, and equity of the credit scoring models. Federated learning, reinforcement learning, and transfer learning are some of the promising contributions resulting from immense advances in the AI paradigm, as they look to move the credit risk assessment to a newer and more efficient level of data-driven decision-making. One example of this is the federated learning solution, where multiple financial institutions can train an AI model with shared, decentralized data sets while the borrower information remains private (Yang et al., 2023). This technique allows credit scoring models to have a rich base of experience data sets but without negatively impacting the ownership rights of a particular data subject.

As for the other machine learning method, there is also Reinforcement learning that is also being considered for use in credit assessment. Reinforcement learning is also different from other machine learning models that have fixed training data information while it involves training the AI models based on borrowers' behaviour (Sutton & Barto, 2022). This approach improves the credit risk early estimation methodologies because it allows AI systems to create a credit control strategy that meets the changing conditions of the finance market. The credit scoring models developed using Reinforcement learning have been proved to be superior to the traditional machine learning models especially when the economic disruptions are considered by Liao et al. (2023).

Another branch of application of credit assessment is also gaining popularity now based on the use of transfer learning in which an AI acquires knowledge from one application and applies it to another. In terms of credit scoring for microfinance, transfer learning enables a pre-trained model from developed countries to be applied to the developing world where the formal credit history is relatively small (Zhang et al., 2023). It cuts down the number of reference to large labelled data thus being significant to financial institutions in data-deficient jurisdiction.

However, this development poses a major issue since AI employs methods that are not easily explainable or understandable by humans in credit scoring. A lot of AI models can be interpreted as black boxes, thus the borrowers, lenders, as well as the regulators cannot decipher how credit decisions are reached. This has led to increasing concerns for the methods that relate to what is known as Explainable AI (XAI), which is designed to ensure that these AI decisions are explainable. Such methods as SHAP and LIME depict how the AI models work on the risk rating of borrowers so that credit decisions made can be defended and reviewed (Ribeiro et al., 2022). To establish greater trust in practices of lending driven by Artificial intelligence, the financial institutions need to incorporate the system of XAI.

Policy and Regulatory Frameworks for AI-Based Lending

Innovations like the application of AI for credit scoring should not be allowed to go rogue, hence the need for governments and financial regulatory authorities to guard the application of innovations with the legal frameworks for the protection of consumers. Due to the lack of an acceptable policy, there is regulatory risk that has caused issues over the application of the AI in the financial sector and especially in lending. Governments need to create codes of conduct for use of data, requirements of algorithmic non-discrimination, and borrower protection in AI-based credit scoring (Wachter et al., 2023).

There is another field where the policymakers can intervene actively and that is to provide and develop clear and uniform ethical protocols for the utilization of the AI in microfinance institutions. Under no circumstances should financial regulations permit any company to employ an AI credit score model without bias tests and fairness audits to ensure that the lending is fairly done and does not discriminate against a particular group of people. Furthermore, the government should require banks to effectively explain to the borrowers how AI made such credit decisions and possible ways of appealing against the decision made to decline the loan application (Hao et al., 2023). To diminish the financial exclusion risk resulting from credit-granting based on AI algorithms, it will be beneficial to guarantee that borrowers have legal remedies.

Another important aspect of regulation on the use of artificial intelligence in lending is the observation of data protection laws. With the advancement in technology, credit decisions involve the use of new sources of data such as mobile phone usage, social media activities among others,

there is need to have legal backing that regulates the manner in which borrower's data is collected, processed or used. Some of the current laws and standards include the EU GDPR as well as data protection laws in other parts of the world must be extended to fit the new risk posed by the use of Artificial Intelligence in credit scoring (Kuner et al., 2023). To reiterate, there must be accountability regarding borrower information where financial institutions should be forced to adopt effective data controls that will counter any illicit attempts of data access.

Moreover, with the increase in the development of artificial intelligence for credit scoring, regulatory sandbox has been seen as a good approach to allow for experimentations with the models in a controlled environment before going to the market fully. This is because regulatory sandboxes enable financial institutions to test AI solutions within certain conditions imposed by regulators to ensure that AI solutions meet ethical and legal requirements before they go mainstream (Arner et al., 2023). The governments should encourage formation of regulatory sandboxes to ensure that innovations are allowed while customer's risks are guarded.

Strategies for Ensuring Fair and Inclusive AI-Driven Lending

In this case, financial institutions must develop specific approaches to harness the use of AI in scoring credits if they are to provide the best results while at the same time upholding fairness, inclusiveness, and data protection. One of the primary interventions in order to reach fair loan lending using artificial intelligence is to increase the model interpretability. There is a need to see to it that the credit scoring models in artificial intelligence are less biased and avoid bias when making lending decisions. This can be done by employing the FA techniques that provide methodologies to make changes to the way that the learning algorithm works for the task assigned, because of the presence of bias in the training data (Mehrabi et al., 2023). Lenders should also need to undergo periodic audits on the models to check for bias when lending credit.

Another area that should be addressed for a more equitable AI-based lending is to enhance the measures of data protection and cybersecurity. This is in light of the fact that alternative data is being used extensively today to access loan customers' information this demand higher level of security measures against cyber criminals. These include encryption technologies, multi-factor authentication of individuals accessing the borrower information, and the use of secure technology in cloud base solutions (Tankard, 2023). Nonetheless, the credit provided through the use of AI needs to follow the data minimization principles whereby the system only considers the relevant data to avoid misuse of the collected data.

AI credit scoring models should also be meant to educate the borrowers and motivate them to actively manage their credit. Some borrowers, especially those in the markets of microfinance may not comprehend the logic used by Alibaba in determining who to fund. Lending firms thus ought to give loan clients an easy-to-understand perception of how they will be evaluated for credit scores, and how they can rectify their ratings (Miller et al., 2023). Cognitive technologies like chatbot and other digital financial advisors should be used to provide the necessary information to the borrowers.

Last but not the least; to spearhead the future of AI credit scoring, financial institutions, technology, and the regulating bodies need to cooperate closely. Coordinated efforts by the banking sector can help promote the best practice adoption process for using AI in lending that is both fair and ethical in its credit scoring models. Cross functional collaboration can ensure that

financial institutions and other relevant stakeholders make progress towards the development of a responsible AI based lending platform.

Conclusion

Based on the analysis of credit scoring with the incorporation of artificial intelligence, the level of credit availability has increased, credit risk quality has been boosted, and credit inclusion achieved in the marketplace especially for the disadvantaged groups. Artificial intelligence systems have helped MFIs to analyse credit scores through new sources and improve their lending decisions for those who do not have credit histories, as well as ensure faster accuracy and decision-making without the need for human interference. Such developments have made it possible for lenders to extend their services to the rural areas, the women, and small businesses that have in the past been locked out of financial service providers. Nevertheless, there are several issues that keep existing in the way of implementing an AI-based credit scoring model in MFIs, as they are: Data privacy concerns, Algorithm bias, legal barriers, and technical infrastructure. The requirement for fairness and accountability of lending by artificial intelligence remains a concern, as shown by how past data can continue to perpetuate injustices in the financial sector. With immediate advancement in the use of technology in credit assessment, it is hopeful that progress in adopting measures that will enhance the balance between innovation and the moral aspect of implementing such technologies will be observed in the future. To ensure fairness, accountability, and security in the lending process aided by Artificial Intelligence, governments, financial regulators, and industry leaders must work together in establishing proper guidelines that would govern the use of artificial intelligence in the lending business. When used in the right manner and with the application of ethical standards, the utilization of AI could help deliver more efficient and accessible credit system for credit providers and borrowers.

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