

Three Benefits and Three Risks of **AI in the Lending Decision Process**

Understanding how AI improves lending efficiency—
and where it can go wrong.

Consumers and businesses are rapidly adopting artificial intelligence (AI). In the financial services industry, AI can help make quicker decisions for various functional services, including lending. Several AI programs make it easier for people to perform their day-to-day tasks, which can help cut down lending lead times significantly. But AI isn't perfect; there are still several risks organizations need to be aware of around data accuracy, privacy, and security if they want to integrate AI into their lending operational processes.

Three Benefits and Three Risks of AI in the Lending Decision Process

Below are three benefits and three risks associated with AI that lenders should understand.

BENEFITS

Improved Risk Assessment: One of the benefits of AI is its ability to quickly process vast amounts of structured and unstructured data. AI models can evaluate creditworthiness by incorporating nontraditional data sources—such as transaction history, social media behavior, and utility payments—alongside conventional credit scores. It can also detect subtle patterns and correlations that human underwriters might overlook, leading to more precise risk categorization. This allows lenders to build more comprehensive and accurate profiles of borrowers, even those with limited credit histories, which can help lenders provide more tailored opportunities to more people.

Additionally, AI improves the speed and consistency of lending decisions, reducing human bias and operational inefficiencies. Real-time data processing enables continuous risk monitoring, allowing lenders to reassess borrower risk dynamically as new information becomes available. AI-powered systems can also flag potential fraud or identify early warning signs of default, helping institutions take proactive steps to mitigate loss. By enhancing predictive accuracy and decision-making speed, AI contributes to more inclusive, fair, and secure lending practices.

Faster and More Efficient Processing: AI enables faster and more efficient processing in the lending decision process by automating many of the time-consuming tasks traditionally handled by people. From application intake to document verification and credit scoring, AI systems can rapidly analyze and process large volumes of data with minimal manual intervention. AI uses special technologies that extract and interpret information from documents such as pay stubs, bank statements, and tax returns in seconds, streamlining the underwriting process. This automation reduces processing time from days or weeks to mere hours or even minutes, allowing lenders to respond to borrowers much faster.

AI-driven decision engines can also apply complex lending criteria consistently across all applications, reducing errors and ensuring compliance with regulatory standards. These systems can instantly flag incomplete applications, identify discrepancies, and make preliminary lending decisions or recommend actions for human review. This not only

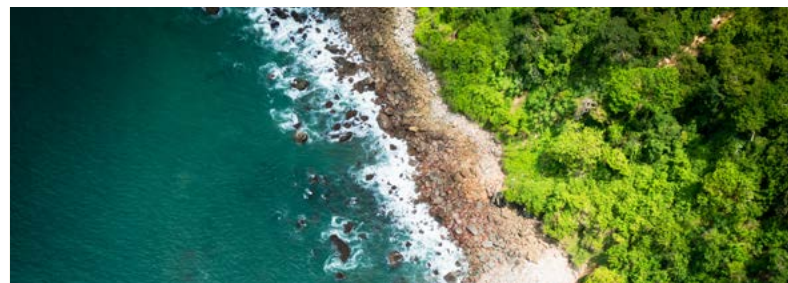
enhances operational efficiency but also improves the borrower's experience by minimizing delays and increasing transparency. By accelerating the full lending workflow, AI can help lenders scale their services while maintaining accuracy and control.

Greater Financial Inclusion: AI can promote greater financial inclusion during the lending decision process by enabling lenders to assess credit risk for individuals who are traditionally underserved or excluded from the formal financial system. Many people in underserved areas lack a conventional credit history, making it difficult for them to access loans through traditional credit scoring models. AI addresses this gap by analyzing alternative data sources such as utility payments, rent history, online transactions, and other nontraditional criteria to evaluate creditworthiness. By leveraging this broader data set, AI helps identify low-risk borrowers who might otherwise be overlooked, providing credit opportunities to a wider and more diverse consumer base.

In addition to broadening access, AI can also help reduce biases that may exist in traditional underwriting practices. Machine learning algorithms, when properly designed and monitored, can offer more objective and consistent assessments of borrowers by focusing solely on data-driven indicators rather than subjective human judgments. This can level the playing field for applicants regardless of their background, geography, or socioeconomic status. As a result, AI not only enhances the reach of financial services but also contributes to building a more equitable and inclusive lending ecosystem.

RISKS

Bias and Discrimination: While AI has the potential to enhance fairness in lending, it can also perpetuate existing biases if not carefully managed. AI systems are trained on historical data, which may reflect past discriminatory practices or systemic inequalities. For example, if a lender's historical data shows that certain demographic groups were less likely to receive loans due to biased decision-making in the past, the AI model may learn to replicate those patterns, even if unintentionally. This could result in lower approval rates for specific racial, gender, or socioeconomic groups, thereby reinforcing exclusions AI is supposed to eliminate.



Moreover, AI models often rely on proxy variables that may correlate with protected characteristics like race or zip code, even if those characteristics are not explicitly included in the data. This indirect bias can be difficult to detect and correct without rigorous testing and transparency. If financial services organizations want to use AI in their lending process, they need to ensure the models are properly trained to identify and eliminate bias, and humans still need to monitor results to ensure the data is fair and conforms with the Community Reinvestment Act (CRA) and other regulatory criteria.

Lack of Transparency: AI makes recommendations and determinations by analyzing several complex data sources, but it doesn't necessarily provide specific justification for its decisions. In the lending process, many variables can lead to a loan's approval or denial. When AI provides a decision without clear logic as to why that decision was made, borrowers and even lending professionals may struggle to comprehend why a particular application was approved or denied. This lack of explanation can lead to confusion, mistrust, and challenges in disputing or appealing decisions, especially when individuals are unaware of the specific criteria or data points that influenced the outcome.

In addition, the use of proprietary algorithms by financial institutions can further obscure the decision-making process. Lenders may be reluctant to reveal how their AI systems work, citing intellectual property concerns, which limits transparency for both borrowers and regulators. This can hinder efforts to ensure fairness, accountability, and compliance with anti-discrimination laws. Without clear explanations and accessible reasoning behind AI-driven decisions, affected individuals may feel powerless, and regulators may find it difficult to enforce ethical and legal standards. Ensuring transparency in AI systems requires deliberate design choices, such as the use of interpretable models and regular audits, to build trust and protect borrower rights.

Data Privacy and Security Risks: AI introduces data privacy and security risks during the lending decision process because it relies heavily on collecting, storing, and analyzing vast amounts of personal and financial information. To assess creditworthiness accurately, AI systems often pull data from multiple sources, including bank records, employment histories, credit histories, and even geolocation data. This expansive data collection increases the risk of sensitive information being mishandled, leaked, or accessed without proper authorization. If these systems are not properly secured from both internal and external threats, they could become targets for cyberattacks, potentially exposing borrowers' private information and compromising their financial safety.

The integration of AI into lending decisions also raises concerns about how data is used and who has access to it. Borrowers may not be fully aware of what data is being collected, how long it is stored, or how it is shared with third parties, leading to potential violations of privacy rights. In the absence of clear regulations and robust data governance practices, financial institutions risk misusing personal data or failing to protect it adequately. Ensuring strong encryption, transparent data usage policies, and strict access controls is essential for maintaining trust and protecting the rights of borrowers in AI-driven lending environments.

ProSight's Risk Management Academy Can Help Your Organization Prepare for Regulatory Changes

ProSight Financial Association empowers financial services leaders to strengthen and advance our industry. Formed through the merger of BAI and RMA—trusted organizations with rich histories and deep expertise in risk, fraud, compliance, and retail and commercial banking—we provide connections, training, insights, tools, and analytics to help you act with confidence.

The ProSight Policy Manager helps financial services organizations make informed decisions when creating, updating, communicating, and tracking their organizational policies and procedures.

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