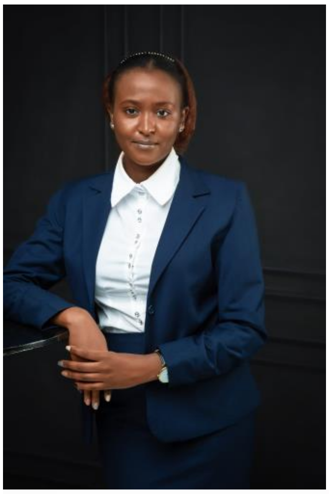
LEGAL TAKE

# SAFEGUARDING YOUR DATA IN THE ERA OF AUTOMATED CREDIT SCORING



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**INTRODUCTION:**

Automated credit scoring refers to the process of using machine learning algorithms and statistical models to assess the creditworthiness of individuals or businesses. This process involves analysing a wide range of data, including credit history, income, employment status, and other financial indicators. The rise of automated credit scoring has revolutionized the way lenders evaluate credit risk. Using sophisticated algorithms and machine learning techniques, that offer financial institutions a faster, more accurate, and more efficient way to assess creditworthiness.

By analysing large volumes of data, automated credit scoring algorithms can generate a credit score that predicts the likelihood of a borrower defaulting on a loan. While automated credit scoring has many potential benefits, such as increased access to credit for underserved communities, there are also significant dangers associated with this practice.

To this end, this article will highlight the regulatory framework on automated credit scoring in Kenya, risks of using automated credit scoring and mitigating measures that may adopted.

## 1. ***Regulatory Framework in Kenya***

The Constitution guarantees the right to privacy, including the right to control the collection, use, and disclosure of personal information. This means that borrowers have a fundamental right to protect their personal information from unnecessary or unlawful interference. More specifically, Section 35 of the Data Protection Act of 2019 (the Act) provides that borrowers have a right not be subjected to decisions that are solely based on automated processing. However, the Act limits this right, stating that the right does not apply where the automated decision is:

- necessary for performance of a contract;
- authorized by law; or
- based on the consent of the individual.

Where a financial institution decides based on automated processing, they shall notify the borrower of the decision. In such an instance the borrower shall have the option of requesting the financial institution to:

a) reconsider the decision; or

b) take a new decision that is not based solely on automated processing.

Upon receipt of such a request, financial institutions are required to consider the request, include any information provided by the borrower that is relevant to it or comply with the request and/or inform the individual in writing the steps taken to comply with the request, and the outcome of complying with the request.

Further to the above, the Data Protection Regulations provide that when financial institutions use automated decision-making they shall:

a) inform the borrower when engaging in processing;

b) provide meaningful information about the logic involved;

c) ensure transparency and fairness requirements are in place, the borrowers rights to oppose profiling are present and where processing operation is likely to result in high risk to the rights and freedoms of a borrower, a data protection impact assessment shall be carried out.

d) explain the significance and envisaged consequences of the processing.

e) ensure the prevention of errors.

f) use appropriate mathematical or statistical procedures.

g) put appropriate technical and organizational measures in place to correct inaccuracies.

h) process personal data in a way that eliminates discriminatory effects and bias; and

i) ensure that a borrower can obtain human intervention and express their point of view.

## 2. *Risks of using automated credit scoring*

Automated credit scoring, while beneficial in certain aspects, poses significant risks to borrower some of which are highlighted below:

a) **Biases**

Automated credit software is only as good as the data input by individuals. If the data used to build the credit scoring model is biased or incomplete, it can lead to inaccurate predictions and potentially unfair lending practices. For instance, if the training data only includes borrowers from a certain demographic group, the resulting credit scores may not accurately reflect the creditworthiness of borrowers from other groups. Algorithms can reinforce existing biases in the data, leading to discriminatory lending practices. In the

United States of America, there have been numerous reports of automated credit scoring models being biased against people of colour and low-income individuals. In 2018 an investigation by ProPublica found that a popular credit scoring model used by major financial institutions was twice as likely to label African American and Hispanic borrowers as high risk compared to white borrowers with similar credit profiles.

b) **Lack of transparency**

Automated credit software can be complex and difficult to understand, making it challenging for humans to identify errors or biases in the models. Lenders may intentionally withhold important details in the automated credit scoring process which makes it difficult for borrowers to understand why they were denied credit or how their credit scores were calculated. This lack of transparency can lead to a lack of trust in the lending process, which can ultimately harm both borrowers and lenders. In Kenya, some digital lenders have been accused of using opaque automated credit scoring models that penalize individuals for factors such as living in certain neighbourhoods or having low-income jobs. This has led to widespread complaints from borrowers who have been denied credit or charged high interest rates despite having good credit histories.

c) **Exploitation of borrower limitations**

Automated credit software can be used to target vulnerable borrowers with unfavourable credit offers. For example, a lender may use behavioural insights to determine which borrowers are more likely to accept an unfavourable contract without careful review. This can result in borrowers accepting loans with high interest rates or hidden fees, leading to financial hardship, and potentially defaulting on their loans.

d) **Over-reliance on past credit history**

Many automated credit scoring models heavily rely on an individual's past credit history to determine their creditworthiness. However, this approach can be problematic for people who have a limited credit history or have made mistakes in the past. For example, a person who missed a few payments years ago may still be penalized by automated credit scoring models, even if they have since improved their financial situation.

e) **Inaccurate inferences made due to profiling.**

Profiling occurs where certain inferences are made from tendencies, psychological and behavioural characteristics. Automated credit scoring models may result in profiling of potential lenders leading to inaccurate results, which can lead to incorrect decisions about creditworthiness. For example, a model may incorrectly flag an individual as a high credit risk based on incomplete or outdated information or general behavioural or psychological characteristics linked with a particular group of individuals.

## 3. *Mitigation Measures*

To mitigate these risks, financial institutions and other organizations should implement appropriate measures such as:

a) **Transparency and Fairness in Data Collection**

Transparency measures should include clear and concise explanations of the credit scoring process to borrowers. Before automated credit software is put in place, financial institutions should inform the customer of their intention through a privacy policy or means of consent.

Lenders must specify all the data that they intend to collect and how they intend to use it. The proposed use should be in line with the reasonable expectations of the borrower. In addition to these measures, financial institutions and organizations should also consider incorporating explainable artificial intelligence techniques into their credit scoring systems. These techniques can help to increase transparency and provide clear explanations of how credit scoring decisions are made.

b) **Human Oversight**

Lenders should have a team of credit analysts review the results produced by automated credit scoring systems to ensure that they are accurate and consistent with established criteria. This can help to identify any errors or biases that may have been introduced into the credit scoring process and ensure that borrowers are not unfairly penalized.

Human oversight can involve the review of automated credit scoring results by credit analysts to ensure that the results are accurate, unbiased, and consistent with established criteria. Financial institutions should also consider implementing a diverse and inclusive team of experts who are responsible for developing and maintaining their credit scoring systems. This can help to ensure that the systems are designed and tested with a variety of perspectives, reducing the risk of bias and increasing the accuracy of the credit scoring process.

c) **Data Quality**

This calls for the use of high-quality data sources and periodic audits of the data used in the credit scoring process to ensure accuracy and completeness. Additionally, this can help to ensure that the credit scoring algorithms are based on accurate and reliable data, which can improve the accuracy of the credit scoring process and reduce the risk of errors or biases.

d) **Privacy by Design/Cybersecurity Measures**

The Act requires that data protection measures must be incorporated by design or by default. Cybersecurity and privacy by design measures involves the implementation of strong access controls, encryption, and regular vulnerability assessments to prevent unauthorized access and data breaches. This can help to protect borrowers' sensitive financial information and prevent it from falling into the wrong hands. By implementing these measures, financial institutions and organizations can help to ensure that their credit scoring systems are secure, borrowers' personal information is protected, and trust is created between lenders and borrowers.

e) **Handling Complaints and Disputes**

Financial institutions should put in place avenues for borrowers to appeal credit scoring decisions and should be transparent and easily accessible to borrowers. By providing borrowers with clear avenues for appealing credit scoring decisions, financial institutions can help to ensure that borrowers are not unfairly penalized and that the credit scoring process is transparent and fair.

By implementing these measures, financial institutions can mitigate the risks associated with automated credit scoring systems and ensure that their credit scoring processes are accurate, unbiased, and transparent.

**Conclusion**

The protection of borrowers in the context of automated credit scoring is crucial to maintain trust in the financial sector and protect the rights of individuals. By adhering to the provisions of the Act and Regulations and implementing appropriate mitigation measures, financial institutions can ensure that their credit scoring processes are fair, accurate, and compliant with applicable laws and regulations.

In case you require further information on this topic, please get in touch with **Diana Wariara** at wariara@fmcadvocates.com

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