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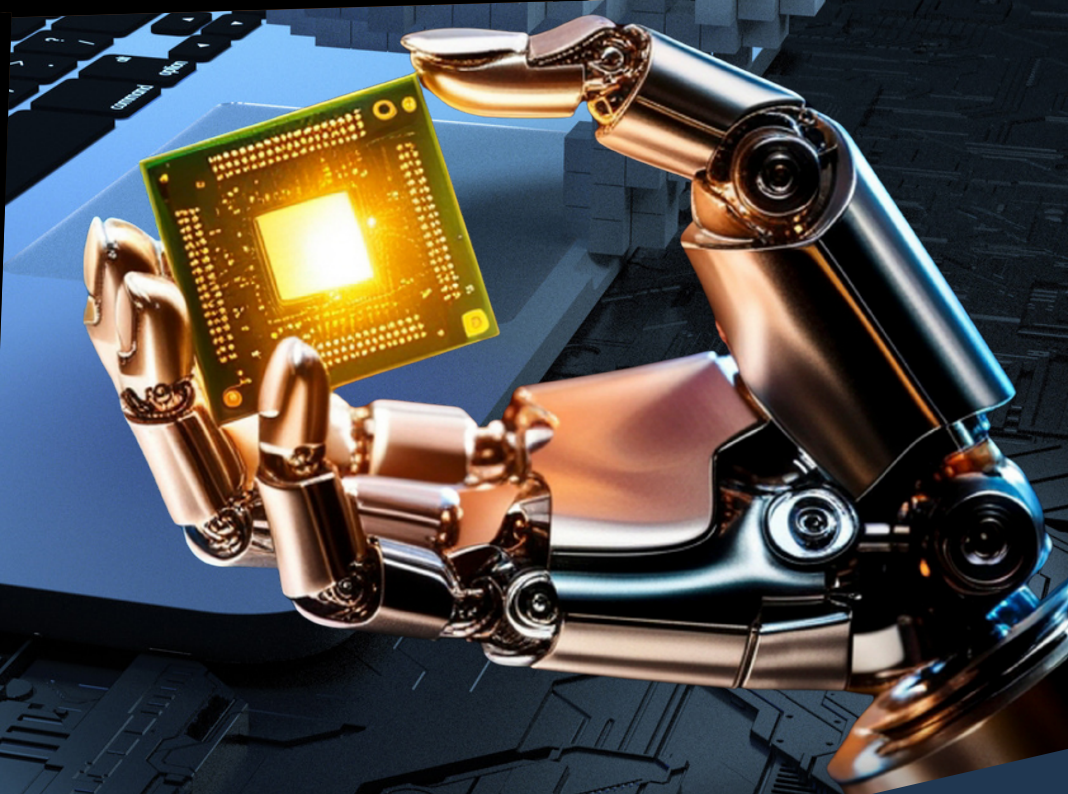


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ARTIFICIAL INTELLIGENCE (AI) IN BANK LENDING: MOVING BEYOND HEURISTIC- BASED CREDIT

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INTRODUCTION

Artificial Intelligence (AI) is transforming loan approval practices in the global banking sector. Its introduction has reshaped the lending landscape by redefining decision-making processes, positioning AI as a decision-support mechanism in which routine assessments are automated. Human expertise is directed towards exception handling, ethical oversight, and strategic risk assessment. In Malaysia, regulatory emphasis on responsible AI adoption highlights the need to balance efficiency gains with transparency, explainability, and accountability (Bank Negara Malaysia, 2025). Effective governance frameworks seek to ensure that AI reduces behavioural bias without introducing systematic risks or undermining trust in the banking system.

Loan approval has traditionally been a judgement- intensive process, due to its heavily reliance on human discretion. Credit officers typically evaluate borrowers using financial ratios, credit history reports from various agencies, and qualitative impressions formed through documentation reviews and interviews. While professional judgement plays an important role, behavioural finance research has long established that human decision-making is subject to heuristic, cognitive limitations and emotional biases, particularly under conditions of uncertainty and time pressure (Kahneman, 2011). The emergence of AI in banking reflects an effort to reduce these decision-making risks by introducing data-driven, consistent, and scalable lending systems. Both globally and in Malaysia, increasingly deploying AI to support or automate loan approval decisions, with the aim of improving efficiency, accuracy, and governance (Bank Negara Malaysia, 2025).

CHRONOLOGICAL EVALUATION OF LENDING PRACTICES AND DECISION BIAS

Heuristic-Based Human Lending Decisions

In traditional commercial lending, credit decisions were primarily made by human officers using rule –of –thumb heuristics, such as over-reliance on collateral value, firm reputation, or prior lending relationships. Behavioural finance literature identifies several cognitive and emotional biases commonly affect lending decisions, including representativeness bias, where borrowers are judged based on stereotypes rather than objective risk indicators; anchoring bias, where initial credit scores or past repayment behavior overly influence current decisions; overconfidence and illusion of control, where credit officers overestimate their ability to predict borrower performance; and loss aversion, which may lead to excessive risk avoidance and credit rationing (Kahneman & Tversky, 1979; Thaler, 2016)

These biases may result in inconsistent credit decisions, mispricing or risk, and exclusion of potential creditworthy borrowers, particularly small and medium-sized enterprises (SMEs) and first-time applicants

Statistical Models and Early Automation

The introduction of statistical credit scoring models represented an early attempt to reduce subjective judgement and behavioural biases. Technique such as logistic regression and discriminant analysis offered greater consistency by standardising decision criteria. However, these models relied on limited variables and continued to require human interpretation, leaving room for discretionary overrides and behavioural influence.

AI Machine Learning – Driven Lending

AI-based lending system represent a further evaluation by systematically reducing heuristic-driven judgement. Machine learning models analyse large datasets, identify complex patterns, and apply consistent decision rules across layers of applicants. AI systems, unlike humans, are certainly not affected by fatigue, social, and emotions pressure, making them particularly efficient at minimising cognitive biases such as overconfidence, anchoring, availability bias, loss aversion bias, and others.

In Malaysia, AI-powered loan origination systems are increasingly automating credit assessment, reducing manual interventions in early-stage approvals and standardising risk evaluation across borrower segments (Bank Negara Malaysia, 2025; Berita Harian, 2025).

AI AS A TOOL FOR MITIGATING COGNITIVE AND EMOTIONAL BIASES IN LENDING

One of the most significant advantages of AI in loan approval lies in its ability to reduce behavioral distortions inherent in human decision-making. By relying on algorithmic assessment rather than intuition, AI systems promote consistency by applying the identical evaluation criteria across all applicants, with the by prioritising empirical risk indicators over subjective impressions, and bias reduction by limiting discretionary overrides driven by emotions or personal judgement

AI-assisted lending decisions exhibit lower variance and improved predictive accuracy compared with purely human-based assessments (Berg et al., 2020). Furthermore, AI system can counter emotionally driven decision-making under stress, such as excessive risk aversion during economic downturns, by maintaining data-driven lending thresholds. This capability is particularly relevant for banks managing cyclical credit risk and portfolio stability.

While AI mitigates many human cognitive and emotional biases, it does not eliminate bias entirely. Instead, biases may shift from human heuristics to algorithmic design. When training data reflects historical discrimination or exclusion, AI models may replicate or amplify these patterns, giving rise to algorithmic bias (Barocas et al., 2023). Moreover, excessive reliance on AI may create automation bias, whereby human decision-makers defer unquestioningly to algorithmic outputs, even when contextual judgement is required. This underscores the important of human governance, especially in complex commercial lending decisions.

CONCLUSION

AI has transformed loan approval processes by reducing reliance on heuristic-based human judgement and mitigating the cognitive and emotional biases inherent in traditional lending practices. It can be seen that the use of AI globally and locally reflects progress toward more consistent, data-driven, and scalable credit assessment. Through its impact, AI is not always neutral, and its effectiveness critically depends on governance structures, data quality, and ongoing human oversight. There is no denying that a balanced human – AI approach remains essential to ensure fair, transparent, and resilient lending practices.

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