

An Overview of Personal Loan Segment in the Light of New Age Intermediate Debt Trap and the Importance of Financial Literacy

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Abstract: *The pressure of the pandemic situation and the resultant economic chaos need no elaboration. The financial crunch caused due to pay cuts, loss of employment has severely affected not only the saving potential but also increased the debt burden for many. The poor judgement made in the selection of lenders from the digital platforms have proved costly for many individuals especially in the Small Ticket Personal Loan segment. The study echoes that lack of financial literacy and an affinity towards easier access to money has exaggerated the problem that has crept deeper into the society and in the personal lives of the victims of these financial fraudsters. The panacea depends on increasing the financial literacy programs along with clarity and tightening of regulations for the digital lenders.*

Key words: *Personal loan, digital finance, debt trap, loan apps, financial literacy*

1. INTRODUCTION

Indian Economy has suffered a chronic investment slowdown due to the ongoing pandemic. The economy was slowing even prior to 2020, with bank failures, stressed balance sheets and a weak labour market. Several liquidity enhancing measures and special refinance facility for infusing liquidity in the system were undertaken at appropriate junctures by the Reserve Bank of India. In order to mitigate the impact of the pandemic situation on the economy, the central bank has decided to continue with the accommodative stance in terms of monetary stimulus and as a result the repo rate would continue with the low 4% as a measure to revive growth in the economy. The Marginal Standing Facility (MSF) and the Bank rate would remain unchanged at 4.25% (RBI, 2021).

On the fiscal stimulus front, the growth oriented measures are carefully undertaken, some of which includes sector specific relief packages, measures to boost formal employment, no new taxes etc. along with carefully dismantling the lockdown clearly focussing to revive growth.

The economic downturn and the uncertainty with regards to the pandemic situation even as the vaccination rolls out, continues to mutually influence each other and play havoc in the

system hampering the economic development. The labour market took the brunt of the pandemic with millions absolutely having no choice but to accept deep pay cuts, while many even lost their jobs both in the organised and unorganised sector. The pressure of the situation has transformed many people from savings centric, loan avoiding individuals to frequent borrowers. It is in this precarious situation, that the economy is combating another challenge in the fringe banking arena in the form of mushrooming unauthorised loan apps. Apparently, the identity of these loan apps and its modus operandi has caught the attention of RBI. In general, any organisation that lends money to the public must be approved by the Reserve Bank of India (RBI), but scores of lenders operate unlicensed through apps that can be easily downloaded. Some of them tie up with banks or NBFCs and act as their outsourcing partners for marketing and on-boarding customers. Hence, RBI(2020) has mandated the digital lending platforms which are used on behalf of Banks and NBFCs should disclose name of the Bank(s) or NBFC(s) upfront to the customers.

The rest of the paper has been structured as follows. Following the Introduction is Section I, which reviews the literature focussing on the factors that plays a critical role in the decisions pertaining to loans taken by individuals along with the research methodology, Section II highlights the landscape of a. personal loan segment, b. risk profiling of the borrowers by the lenders and c. the alternative borrowing platform. Section III enumerates the debt traps by the loan apps and Section IV recapitulates the conclusion of the study.

2. REVIEW OF LITERATURE

The financial system is growing continuously and bubbling with cluster of markets, institutions, instruments and regulations enabling the expansion of the scope for neo age financial products and services. A decade ago, Census 2011 discloses that out of 24.67 crore households in India, only about 14.48 crore or 58.70 per cent households had access to banking services. Further, of the 16.78 crore rural households only about 9.14 crore or 54.46 per cent households were availing of banking services. (RBI, 2014).

For improved economic development, a broader financial inclusion is imperative and the Government and RBI have been vigorously pursuing through multiple platforms towards the same. The Pradhan Mantri Jan Dhan Yojana was a remarkable result that fetched a World Record in the Guinness Book (2014) for the most bank accounts opened in one week as a part of the financial inclusion campaign by the Government of India from August 23 to 29, 2014. Amidst the various efforts to include all sections of population in the mainstream financial system, it is reported by the World Bank (2017) that almost half of the account holders in India have had a bank account that remained inactive in the past year.

In spite of the laudable efforts in terms of financial inclusion, the prevalence of financial exclusion cannot be swept under the carpet. Kempson (1999) in his research discusses five forms of financial exclusion in the society, viz., access exclusion, condition exclusion, price exclusion, marketing exclusion and self-exclusion.

The financial inclusion addresses only the entry level problems. The formal financial institutions driven by profit maximisation, at the same time not wanting to compromise on safety, operates with a different horizon to individuals with different economic background as they focus on clientele with higher credit scores or who can provide a better collateral. The transactional problems are faced by the ones who cannot provide them. The research by Kislal et al. (2013) in their working paper, indicates that the formal lenders rely about 40% more often on collateral than informal lenders. This especially is prevalent in the personal loan segment. The neglect along with lack of financial literacy proves to be a disastrous

combination that leads the individuals to take wrong choices especially with borrowing decisions.

According to Kilborn (2005) borrowing decisions of consumers seem to be under the influence of biases (cognitive illusions) and heuristics (mental shortcuts). Individuals tend to overvalue present benefits and ignore future costs, by underestimating the risk involved in excess borrowings.

A study by Persson (2008) indicates that over-indebted consumers are more likely to experience physical and mental health problems, depression related symptoms of illness, thoughts of suicide and feelings of helplessness. Over-indebted people may face difficulties in finding employment and are also prone to social exclusion.

There have been a lot of research that has focussed on the financial literacy and the financial decision making with respect to portfolio selection or asset allocation. The study often uses the three financial literacy questions developed by Lusardi and Mitchell (2014) trying to determine the understanding of individuals on inflation, interest rates and risk.

On the other hand research has also been focussed on the level of financial literacy and its impact on the borrowing. A study by Nurdan et al. (2012) measures the effects of financial literacy of Turkish financial consumers on the borrowing behaviour. The results reveal that there are differences in the borrowing behaviour of consumers with different levels of financial literacy.

The study by Lusardi & Tufano (2009) in the Working paper “Debt literacy, financial experiences, and over indebtedness” published in the National Bureau of Economic Research reports that individuals with lower levels of debt literacy exhibit tendency to transact high-cost borrowings and the ones with higher level of financial literacy is less likely to exhibit excessive borrowing behaviour. The repost by Lusardi & Tufano (2011) indicates that lack of financial sophistication is one of the main reason that leads people to over borrowing by choosing costly mortgages.

Millennials are no exception for lacking in financial literacy. A study by Lusardi, Scheresberg, and Oggero (2017) reveals that many of the youngsters have not even attempted to calculate the payments associated with the student loan that they have taken. The study reveals that if given a chance to revisit the loan borrowed for their education, many had indicated that they may have taken a different decision.

The revolution in the digital world has had a great impact on the financial technology. One of the study by Lusardi (2019) discloses that the exponential growth in financial technology (FinTech) is revolutionizing the way people make payments, decide about their financial investments, and seek financial advice. In this context, it is important to understand how financially knowledgeable people are and to what extent their knowledge of finance affects their financial decision-making.

In the recent past, the popularity of online lending portals for borrowing or lending besides traditional route is growing especially with respect to unsecured loans. The study by Bachmann et al. (2013) reveals that the digital platform enables the borrowers and lenders trade directly without the intervention of formal institution. In such portals, the personal information has an important influence on loan performance, borrowing, and lending decisions.

Research on online P2P lending has revealed that impressions of trustworthiness matter in financial transactions. Duarte et al. (2012) found that even appearance of borrowers also has a significant impact on the success rate of loans.

The study by Carney (2019) reveals that, FinTechs have played an important role in unbundling banking into core functions of settling payments, performing maturity

transformation, sharing risk and allocating capital. Hendrikse et al. (2018) reveals that the information and telecommunications (IT) revolution is regarded as the fifth ‘Technological Revolution’ driving growth and FinTech is at the helm of this creative disruption. According to Mankotia (2020) India has emerged as the fastest growing FinTech market and the third largest FinTech ecosystem in the world. The country has the highest FinTech adoption rate globally of 87% which is significantly higher than the global average rate of 64%.

The current research, having documented various studies on financial inclusion, importance of financial literacy and the revolution in terms of borrowings in the digitized economy moves its focus on capturing the overall landscape of personal loan segment and particularly highlights the threats of pay-day loans in the fringe banking segment.

3. RESEARCH METHODOLOGY:

Need of the study: While banking sector of India has been of research interests to many researchers, the exclusive study on the alarming increase in the financial fraud in the fringe banking area in the form of loan apps is not available. The paper aims to plug that research gap.

Objectives of the Study

1. To overview the personal loan segment
2. To understand the debt traps in the digital financial system.

Methodology of the study

The study is purely based on secondary data collected from the official website of Reserve Bank of India and various financial institutions and service providers. Also the study uses data from published journals and articles.

4. FINDINGS AND DISCUSSION:

Objective I - To overview the personal loan segment

In order to have an overall understanding of the personal loan segment, it is imperative to understand the following:

- a. The structure and fragmentation of personal loans
- b. The risk profiling of the borrowers and
- c. The alternative borrowing platforms.

a. Understanding the structure and Fragmentation of Personal Loan Segment:

The increasing gap of income and expenditure along with the rising costs, propel the growth of personal loan segment in the country. The industry growth of this segment in the retail asset product, has seen the most dramatic changes in terms of the product design and customer segment. According to an RBI (2020) the personal loans continued to record robust growth as their share in total credit has gradually increased to 24.0 per cent in March 2020 from 16.6 per cent five years ago.

The personal loan market can be fragmented on basis like source, purpose, quantum, security, tenure and interest rate. As regards the source, the personal loan market’s landscape includes, traditional sources like public/ private sector banks on one hand, while on the other it includes Non-Banking Finance Companies (NBFC) and neo age lenders consisting of FinTech and Peer to Peer lending (P2P). In general, the neo age lenders target the young, technology savvy lot with limited credit history. With respect to the purpose, the market

consists of (a) consumer credit, (b) education loan, (c) loans given for creation/ enhancement of immovable assets (e.g., housing, etc.), and (d) loans given for investment in financial assets (shares, debentures, etc.)(RBI, 2018). As regards the quantum, the minimum and the maximum loan varies from lender to lender. For instance, State Bank of India (2021) offers a maximum personal loan of Rs 15 lakh for salaried and self-employed professionals. On the other hand the an NBFC like Bajaj Fin serv offers an instant personal loan of Rs 25 lakh (maximum) for a salaried employee with minimal documentation. With respect to security, personal loans are mostly unsecured in nature with minimal to less documentation, but there are some that requires collateral. In terms of tenure, usually, a personal loan is offered for a maximum of five to six years by lending institutions such as banks(SBI, 2021). However, the tenure can vary from lender to lender, depending on whether it is provided by a bank or NBFC or any neo-age lending mechanism like P2P. As regards the interest rate, it yet again depends on the institution from where the loan is taken. For instance, according to RBI (2011) formal institutions like banks are free to determine the rates without reference to Benchmark Prime Lending Rate (BPLR) as it is deregulated but care should be exercised to ensure that usurious interest, processing fees and other charges are not levied so as to conform to the guidelines of normal banking practices. It has to be remembered that normally the interest rates charged on personal loans are much higher than on home loans or loans against gold because the former are unsecured loans.

According to RBI, there are eight sub-categories of personal loans advanced by commercial banks and it includes: Consumer durables, Housing loans, Advances against fixed deposits, Advances against shares, bonds etc. Credit card outstanding, Educational loans and Vehicle loans.

Table – 1 Personal Loan Sector Allocation by Scheduled Commercial Banks

(Rs in crore)							
	Outstanding as on					Variation (Y-o-Y)	
Sector	18.1.2019	29.3.2019	31.1.2020	27.3.2020	29.1.2021	31.1.2020 / 18.1.2019	29.1.2021 / 31.1.2020
Personal Loans	2137064	2220732	2497250	2553649	2724415	16.9	9.1
Consumer Durables	4568	6299	6453	9299	7397	41.3	14.6
Housing (Including Priority Sector Housing)	1120792	1160111	1316473	1338961	1417538	17.5	7.7
Advances against F.D (Including FCNR (B), NRNR)	68721	82873	67240	79494	67176	-2.2	-0.1

Deposits etc.)							
Advances to Individuals against share, bonds, etc.	5841	6265	5185	5334	4163	-11.2	-19.7
Credit Card O/S	84237	88262	110864	108097	116361	31.6	5.0
Education	69176	67988	67038	65744	64364	-3.1	-4.0
Vehicle Loans	200582	202154	220240	220610	235882	9.8	7.1
Loans against gold jewellery	15451	18637	18596	26192	43141	20.4	132.0
Other Personal Loans	567696	588144	685162	699919	768392	20.7	12.1

Source: RBI bulletin (2020)

From the above table it can be inferred that the Personal loans growth decelerated to 9.1 per cent in January 2021 from 16.9 per cent in January 2020.

In order to ease the financial stress during the pandemic, the central bank (2020) has been active in supporting the small businesses and retail borrowers sectors by allowing a repayment moratorium and debt recasts. Under the extant framework, the maximum aggregated retail exposure to one counterparty should not exceed the absolute threshold limit of ₹5 crore. In order to facilitate higher credit flow to this segment, which mainly consists of individuals and small businesses (i.e. with turnover of up to ₹50 crore), and in harmonization with the Basel guidelines, it has been decided to increase this threshold to ₹7.5 crore in respect of all fresh as well as incremental qualifying exposure.

According to CRIF India (2020) one of India's leading provider of credit information and a RBI licensed credit bureau, among the various retail asset products, personal loan (PL) has seen some of the most dramatic changes in terms of the product design and customer segment. Inside the segment, Small Ticket Personal Loan (STPL) that consists of personal loans of less than INR 50,000 have been observed to drive volumes by as much as 162% Y-o-Y, as of Mar 2020.

Table -2 Competition landscape of personal loan portfolio market share (by volume)

	Mar -18	Mar-19	Mar -20	Aug -20
Public Sector Bank	40.07%	32.53%	23.83%	24.41%
Private Sector Bank	33.09%	30.09%	27.03%	29.14%
Non-Banking Financial Companies	22.68%	32.97%	44.92%	42.16%
Others	4.15%	4.40%	4.22%	4.29%
Total	100	100	100	100

Source: CRIF India (Dec 2020)

From the above table it can be inferred that NBFCs continue to grow and have almost doubled their market share in the personal loan segment as on March 2020 end. Their market share as of Aug 2020 is 42%. NBFCs including FinTechs are offering a variety of personal loans to customer segments who may not qualify for personal loans via traditional lenders. It also includes tailored offerings to the changing preferences of customers. This could have been the reason for expanding their borrower base rapidly. According to a report titled 'FinTech Collections, Trends and Strategies' by credit bureau TransUnion CIBIL and Digital Lenders Association (2020) a large amount of personal loans originated by FinTech firms in August 2020, were from below prime-risk tier customers (with credit scores of 750 or below), compared to 38% such customers for NBFCs, 25% for public sector banks and 19% for private sector lenders. The share of consumers in below prime segment (subprime and near prime) has increased to 42% in August 2020 from 40% in August 2019.

b. Borrower risk profiles

A consumer's credit score can be an important determinant of their access to credit. Individuals with a good credit score are lender's delight. In India, there are four credit information companies licensed by Reserve Bank of India (2018). These are Credit Information Bureau (India) Limited (CIBIL), Equifax Credit Information Services Private Limited, Experian Credit Information Company of India Private Limited and CRIF High Mark (formerly High Mark Credit Information Services). The most popular credit score in India is the CIBIL rating. The CIBIL credit score is a three-digit number, which ranges from 300 to 900, with 900 being the best score. A good CIBIL credit score is considered to be 750 and above. Higher the credit score, the better are the chances of getting loan approved with progressive higher scores standing a chance for getting additional benefits, such as low interest rates, better repayment terms and quicker loan approval process.

c. Alternative borrowing:

The landscape of banking and financial sector has undergone a phenomenal transformation since 2008 Global Financial Crisis (GFC), owing to financial technology firms, popularly known as 'FinTechs'. Both as creative disruptors and facilitators, FinTechs have contributed to the modern banking and financial sector through various channels including cost optimisation, better customer service and financial inclusion. The scope of operations of FinTechs has also been expanding to horizons untouched by traditional banking.

These alternative lending platforms are bridging the demand supply gap in credit by focusing on new customers and digitising the credit underwriting and disbursement processes. The millennials are spoilt with choices as the Fin Techs are transforming the credit space with their innovative products and services. Also, these fin techs with their innovative approach predominantly target the younger age seeking small ticket, short term loans without impressive credit history. One of the popular alternate borrowing model is the Peer to Peer (P2P) lending. This model aims to provide a marketplace that connects individuals in need for credit with individuals and institutes willing to lend their excess funds. RBI (2017) classified all the P2P lending sites as NBFCs. The aggregate exposure of a lender to all borrowers at any point of time, across all P2P platforms, shall be subject to a cap of ₹ 50,00,000 provided that such investments of the lenders on P2P platforms are consistent with their net-worth. The lender investing more than ₹ 10,00,000 across P2P platforms shall produce a certificate to P2P platforms from a practicing Chartered Accountant certifying minimum net-worth of ₹ 50,00,000. Further, according to RBI (2019) all the lenders shall submit declaration to P2P platforms that they have understood all the risks associated with lending transactions and that P2P platform does not assure return of principal/payment of interest.

Although significant regulatory steps have been taken already in the FinTech, the dynamic nature of this segment keeps throwing up new challenges. Despite the various innovations in this area, they can sometimes magnify threats like privacy breaches or cybersecurity risks to individuals, leaving behind digitally incompetent and the financially excluded lot.

Objective 2: To understand the debt traps in the digital financial system. .

There are no exact figures for the number of Indians borrowing via digital means. India has emerged as the fastest growing app market in the world with 19 billion apps downloaded in 2019, up from 6.55 billion in 2016, according to data from analytics and market intelligence firm App Annie's State of Mobile 2020 report (App Annie, 2020). Many of these apps are offering pay-day loans from unauthorised lenders. The Digital Lenders Association of India (DLAI) says there are 85 digital lenders registered with them who have signed a code of conduct, but there is no account of unregistered digital lenders operating in the country. Sometimes the lack of financial education but the easy access to technology could become an explosive combination. The modus operandi adopted by these loan apps have been typical. The micro lending segment floods the internet offering instant loan, volunteering to credit the required amount in the bank accounts of the needy individual in no time with just a few swipes in their mobile phones, while camouflaging their funding and the technology base. The extension of subprime loans without demanding any hard asset collateral or information about the credit score has attracted many individuals for their short term loan requirements given the quick turnaround time and limited documentation requirements.

The absence of these protocol requirements, lures the individuals who ends up borrowing from them without running any check on whether these companies have acquired licence from the Reserve Bank of India or not. The borrowers then get entangled into a web of financial transactions wrapped in riddles that not only makes them pay exorbitant rates of interest to these loan sharks but also become victims of onerous terms and inhuman, exploitative collection policies resorted by these lenders. Most of these unorganised loans has severe damaging effects on the financial system and the personal life of Individuals and their families.

The increasing penetration of banking services, as well as the shadow banking sector, have given people alternatives to money lenders and other informal sources of credit. A mobile only NBFC must have acquired their licence from RBI. The absence of a definition for digital lenders, has emboldened these unauthorised loan apps, to openly operate in the guise of digital lenders swindling from the gullible individuals. Often the network of these lenders are spread across geographically both nationally and internationally.

Even though the economic condition due to the pandemic may have created the financial crunch, but it is the lack of financial education that leads the naive individuals to believe the lenders without confirming about their authenticity and ultimately falling for the financial frauds.

“Financial literacy is not just about smart investments but it also enables an individual to borrow wisely”

5. CONCLUSION:

The share of retail loan segment in total NPA are rising and even in the retail loan segment, the proportion of personal loan is increasing and probably that's the reason for banks to tighten the formalities regarding the personal loan. This could be a reason for many individuals to go in for other easy sources for their financial requirements without bothering much about the authenticity of the lender. The global lockdowns in light of

the coronavirus pandemic have proved to be a boon for the app economy as people across the world are spending more time on their phones. The phony loan apps are also capitalising the impact of pandemic and its resultant heavy pay cuts, job loss, lack of opportunities and the gaps in the health infrastructure to add to its victim base. The exponential growth in financial technology has brought about a 360 degree change in the way individuals process their entire financial management starting from planning to making payments to even seeking professional assistance for choice of asset allocation. The technology revolution and ease of accessing information along with lack of financial education makes the individuals easy targets for these scammers. Ironically, the government's concerted push for digital finance and the increasing presence of these loan apps for quick money might have been gravely misunderstood due to the lack of financial literacy. The monetary easing is done with little scope for further easing as it could push inflation higher and the possibility for fiscal stimulus is slim as government revenues are already well short of the target, mainly due to the slowdown. The only way to arrest the influx of these financial fraudsters is by educating the public and spreading the financial literacy through innovative, easy and accessible format frequent intervals for all the sections of the society. The RBI has released the National Strategy for Financial Education (NSFE) for a five year period starting from 2020 to 2025. Under this, the central bank has recommended a '5-Core Actions' approach for dissemination of financial education in the country. All the banks play an active role in disseminating the information and create awareness among its customers and general public. The recent step by the Reserve Bank of India to focus on financial literacy is appropriate and timely. Educating the public especially the borrowers may empower them to take wise decisions with respect to borrowings and may as well protect people from falling in unauthorised debt - traps.

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