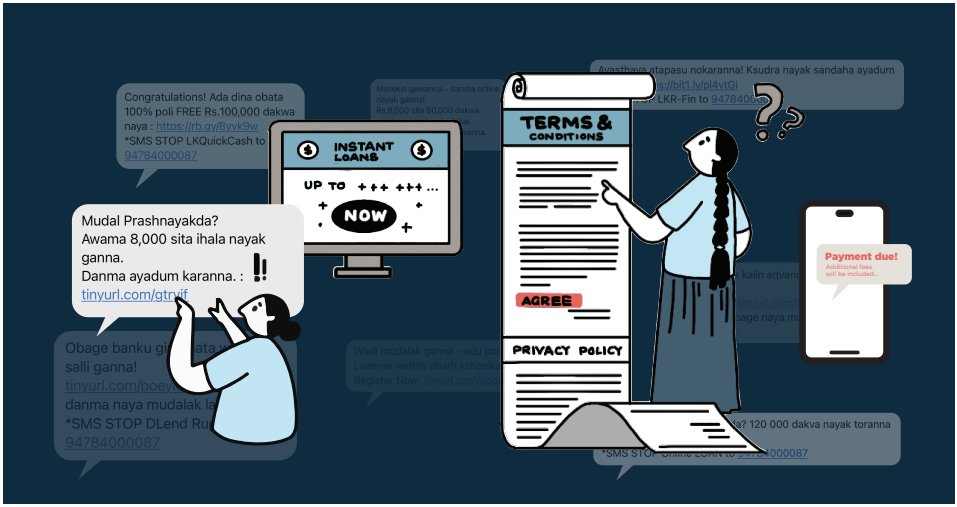
NOVEMBER 2026

Digital Microloans and Borrower Vulnerability

HIDDEN COSTS, DATA RISKS AND REGULATORY GAPS IN SRI LANKA



OVERVIEW

The protracted effects of Sri Lanka's economic crisis and new shocks have deepened household vulnerability, with 22% of crisis-affected households reporting debt. At the same time, rapid growth in mobile connectivity and social media use has transformed how Sri Lankans access financial services, and digital microloan services have become an increasingly common source of fast, collateral-free credit.

Many of these providers are neither licensed nor regulated as financial institutions. Borrowers turn to them for urgent needs such as rent, medical expenses, business costs and children's expenses, often because banks are too slow, too laborious or require collateral they do not have. Apps promote instant approval, minimal documentation and low or zero interest, yet service and late fees can act as hidden interest, pushing borrowers to take new loans to repay old ones. Those who fall behind face repeated calls, threats and reputational harm, while the apps collect extensive personal data, including contacts, photographs and location. Together, these practices expose borrowers to financial, personal and psychological harm in a space with little regulatory oversight.

"The agents from the online loan company messaged my Facebook friends; they called me a fraudster for borrowing money from them and not paying them back"- Ramani*

*All the names have been anonymised.

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KEY FINDINGS

Borrowers often turned to these services to meet urgent needs such as rent, medical expenses, business costs and children's expenses. Most borrowers did not use formal financial institutions as they took too long, had onerous requirements, or asked for collateral they could not provide.

Loan services marketed instant approvals and low or zero interest, yet borrowers frequently reported service fees and late fees that add to borrowing costs. Many borrowers fell into cycles of repeat borrowing to repay existing debts.

Borrowing terms and privacy policies were vague and often unavailable in local languages and restricted borrowers' ability to provide informed consent for the terms of the loans they obtain.

Loan apps collected pervasive personal, financial and device data, including accessing photographs, location and contacts from borrowers' devices. Companies reserved broad powers to share it with third parties, retain it for unspecified periods, and transfer it internationally.

Borrowers who defaulted faced multi-faceted distress - repeated phone calls, threats, intimidation and reputational harm, which damages relationships, employment prospects, and mental wellbeing.

Many services shared developers, marketing strategies and ownership structures and link to international financial technology networks. This suggests a network of companies that, at present, operate in a regulatory black hole.

RECOMMENDATIONS

As these services operate in interconnected networks, responses must also be synchronised and multi-pronged. Financial regulators, digital and cybercrime authorities, and law enforcement must coordinate their actions.

The Microfinance and Credit Regulatory Authority should be established without delay. Under planned revisions to the Act, the MCRA's regulatory ambit must explicitly cover app-based lenders, interest and fee practices, total cost disclosure, recovery practices, rules around marketing, and accessible complaint mechanisms.

The Personal Data Protection Act should be fully enforced from 1 January 2027, with clear guidance on consent, data minimisation and cross-border transfers, to ensure that companies collecting borrowers' personal data are held to clear standards. Until new laws take effect, police stations should accept and act on complaints, and SLCERT and the CCID should be given the capacity and mandate to respond to data misuse and cyber harassment.

Enhancing digital literacy among the public is needed, so that borrowers understand the terms they accept, the personal data they give away, and the risks of these services before they decide to borrow.

Sri Lanka must shift to transformative social protection that goes beyond cash transfers, insurance and pensions to tackle structural inequalities and address the economic circumstances that created the demand for these loans and push households into relying on predatory lending.