

# The State of Small Business Lending Fraud

2023 LexisNexis® Risk Solutions  
Small Business Lending  
Fraud Study



# SMB Fraud Trends and Robust Practices for Fraud Prevention

*Small- and mid-sized businesses (SMBs) are the backbone of the global economy. But in recent years, there has been an alarming increase in SMB lending fraud at all types of institutions – large and small banks, credit unions, and especially digital lenders/fintechs – with the expectation of that trend continuing in the foreseeable future.*

How can lenders mitigate loan fraud while preserving the ease and speed of the customer experience?

The LexisNexis® Risk Solutions SMB Lending Fraud Study surveyed 147 lenders to identify current fraud trends and key pain points related to the addition of new payment mechanisms and online and mobile channel transactions. Other objectives of the study included:

- **Volume of SMB lending fraud and through which channels**
- **How SMB lending fraud is identified and tracked**
- **Types of SMB lending fraud experienced**
- **Priorities and levels of investment for curbing SMB lending fraud**



*In the pages that follow, you'll find the results of the study as well as recommendations for future detection and prevention of fraud in SMB lending.*



# SMB Lending Fraud Increased Significantly the Last 12 Months and Many Financial Institutions Expect It to Worsen Over the Near Term



*Most SMB lending fraud is being caught after the point of origination as lenders remain concerned about balancing fraud detection with minimizing customer friction.*



The average **year-on-year increase in SMB lending fraud** is 14.5%, compared to 6.9% in 2021.



72% of respondents expect SMB lending fraud to continue to **increase over the next 12 months**.



SMB lending fraud losses are likely to represent up to **15% of overall losses**.



The average value of SMB lending fraud losses as a percentage of annual revenue is down slightly from 2021 (5.5% compared to 6.2%) but **remains higher than pre-pandemic levels** (4.2% in 2019).





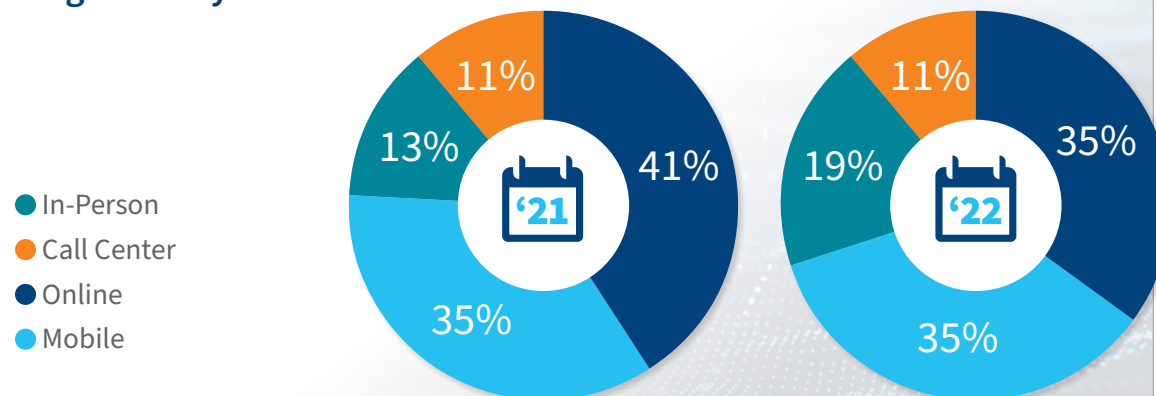
# Remote and Digital Channels Are Driving SMB Lending Fraud

*More than half of fraud losses are based on application volume submitted through remote channels (online/mobile).*

About 19% of SMB lending fraud losses are attributed to post-pandemic changes to how transactions are occurring.

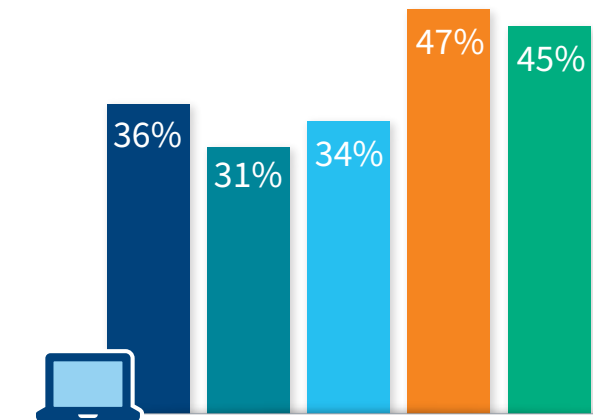
Online and mobile channels continue to be the primary source of SMB loan origination.

## % of SMB Loan Applications Submitted/Loans Originated By Channel



Most SMB lending fraud losses continue to be generated via these remote channels.

## Distribution of Fraud Losses



ONLINE

- Overall
- Smaller Banks/CUs (<\$10B)
- Larger Banks/CUs (\$10B+)
- Fintech/Digital Lenders
- Mostly Digital

**As banks resume in-person operations, there has been a slight uptick in in-person loan applications and associated fraud losses (both up 5% from 2021).**

# Catch Fraud Sooner – Before the Losses Mount

*Most fraud is not caught until after the point of account origination. What if more could be caught during?*

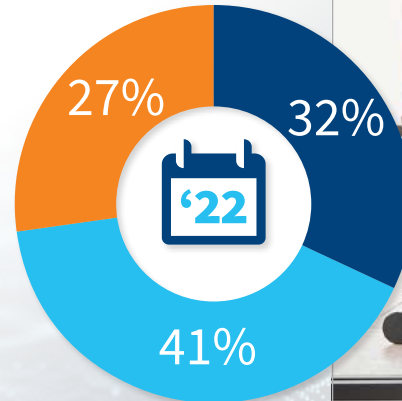
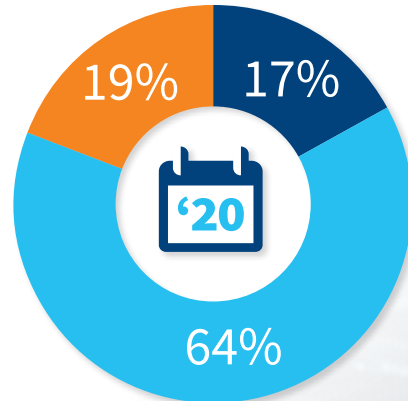


68% of SMB lending fraud is caught after the point of account origination. This is a 15 percentage point decrease from 2021, but what if more fraud could be detected at the point of origination/application?



Of the 68%, 27% aren't identified until the account has charged off.

## Identification of SMB Lending Fraud



- After an account has charged off
- At the point of account origination
- Within the first month of the customer relationship



# It's Increasingly Difficult to Manage Fraud Prevention While Minimizing Customer Friction

*While most lenders acknowledge that SMB lending fraud is inevitable, they also believe that reducing it can help increase their revenues and customer loyalty.*



73% of respondents agree or completely agree it's increasingly difficult to manage fraud prevention while minimizing customer friction.



Respondents who encounter "legitimate business and legitimate consumer/owner identity" fraud sometimes/often increased by 15 percentage points over 2021 to 64%.



Use of legitimate business and owner identity increases the difficulty of managing fraud prevention while balancing customer friction.



# What Works Best to Reduce Fraud: Hire More People or Invest in More Technology?

*Most firms are hiring more people to work fraud cases but some are investing more in new strategies that leverage technology/solutions to mitigate fraud.*



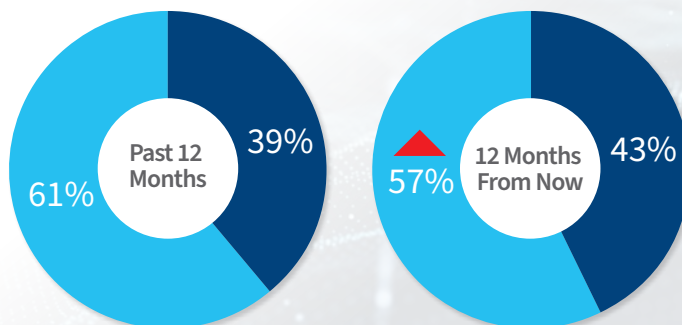
In the last 12 months, the distribution of fraud prevention costs have remained focused on labor though we've seen an increased percentage of investment in fraud prevention solutions from 34% in 2021 to 39% in 2022.



Looking 12 months from now, it's anticipated that the distribution will become more balanced, though still favoring investments in labor.

## Distribution of SMB Lending Fraud Prevention Costs

- Labor/resources
- Fraud prevention solutions

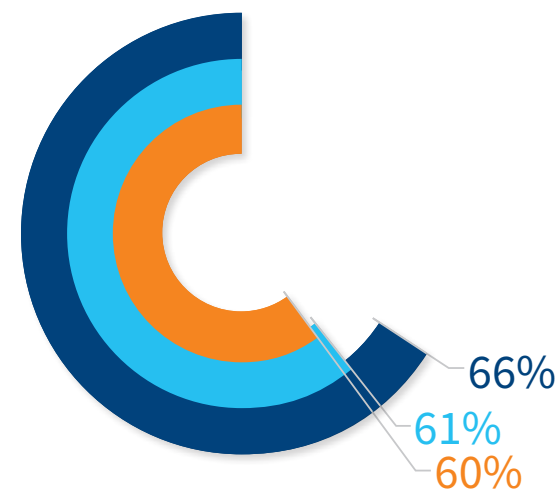


76% of respondents that have made changes in online/mobile transaction policies have decided to tighten them by adding new security features/technology and multi-layer authentication.



72% of firms expect to increase their investment in fraud prevention.

## Activities Being Undertaken to Curb SMB Lending Fraud



- Increasing staffing on fraud teams
- Special fraud prevention initiatives
- Increasing spend on vendor solutions



# Final Thoughts

*Lenders should strive to be proactive in preventing SMB fraud, taking action before any damage is done. But that's not easy. Fraud has become more complex. Often, a variety of fraud risks can occur at the same time. And no one solution is effective at identifying and blocking all fraud.*



What does work, however, is a multi-layered solution approach. Ideally, it should integrate with fraud mitigation and digital channel operations. Any fraud tools must authenticate both digital and physical criteria, as well as identity and transaction risk.



The combination of robust business and identity intelligence, advanced decisioning tools and layered technology gives lenders their best chance at identifying and preventing SMB fraud.

Percent of Respondents That Leverage a Multi-Layered Solution

Layering of Fraud Mitigation Solutions	NO	YES
Fraud Cost as a % of Annual Revenues	5.6%	4.3%
% That Catch SMB Lending Fraud at the Point of Origination	18%	50%
% Very Effective at Detecting and Mitigating SMB Lending Fraud	36%	85%
% of SMB Lending Fraud Attributed to COVID Impacts	60%	40%



# Recommendations



**Assess Digital Identity Attributes:** Identity proofing should include assessing digital identity attributes. Technology is key to this effort of detecting and mitigating fraud while minimizing friction.



**Take a Multi-Layered Solution Approach:**

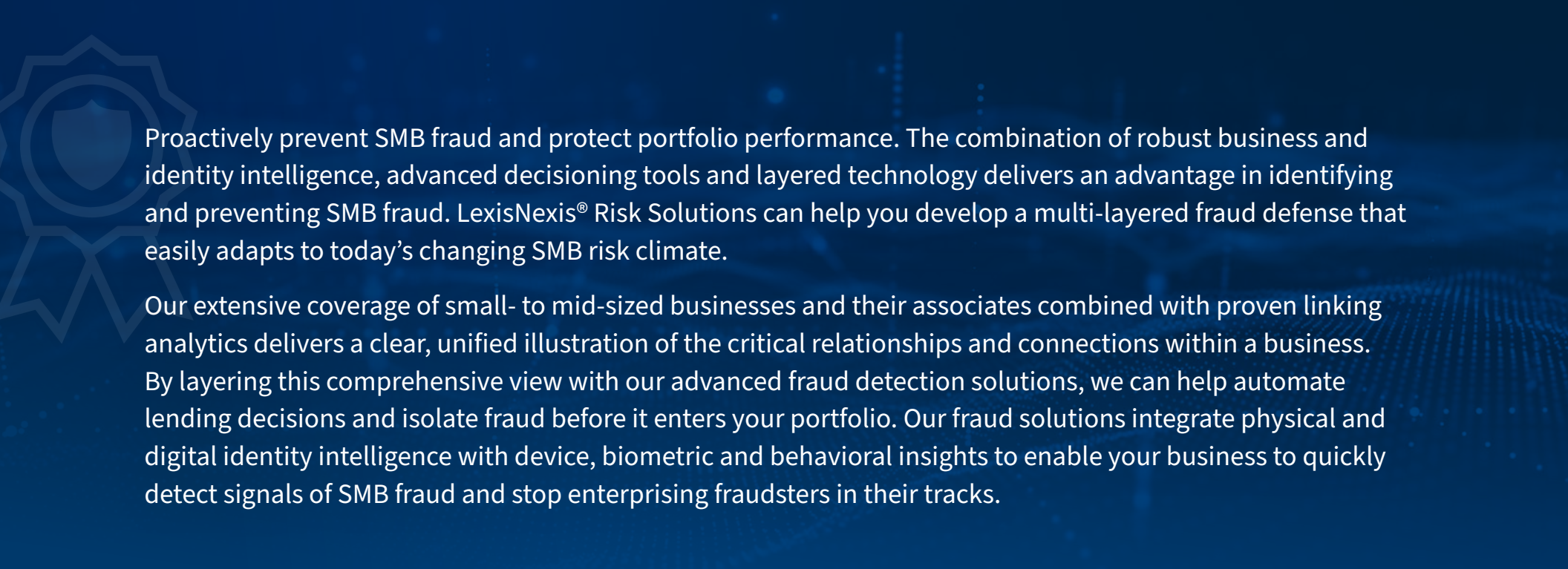
A multi-layered solution approach is required – customized to each phase of the customer journey and transaction channel.



**Protect Endpoints:** Mitigate fraud at the first point of the customer journey by protecting endpoints and using digital identity solutions and behavioral analytics that assess risk while minimizing friction.

*SMBs continue to represent a growth market for lenders. But they need to have the right solutions in place to safely do business with SMBs. Technology is a critical piece of the puzzle for detecting and mitigating fraud while preserving the ease and speed of the customer experience.*





Proactively prevent SMB fraud and protect portfolio performance. The combination of robust business and identity intelligence, advanced decisioning tools and layered technology delivers an advantage in identifying and preventing SMB fraud. LexisNexis® Risk Solutions can help you develop a multi-layered fraud defense that easily adapts to today's changing SMB risk climate.

Our extensive coverage of small- to mid-sized businesses and their associates combined with proven linking analytics delivers a clear, unified illustration of the critical relationships and connections within a business. By layering this comprehensive view with our advanced fraud detection solutions, we can help automate lending decisions and isolate fraud before it enters your portfolio. Our fraud solutions integrate physical and digital identity intelligence with device, biometric and behavioral insights to enable your business to quickly detect signals of SMB fraud and stop enterprising fraudsters in their tracks.

For more information, visit [risk.lexisnexis.com/SMBrisk](https://risk.lexisnexis.com/SMBrisk)



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