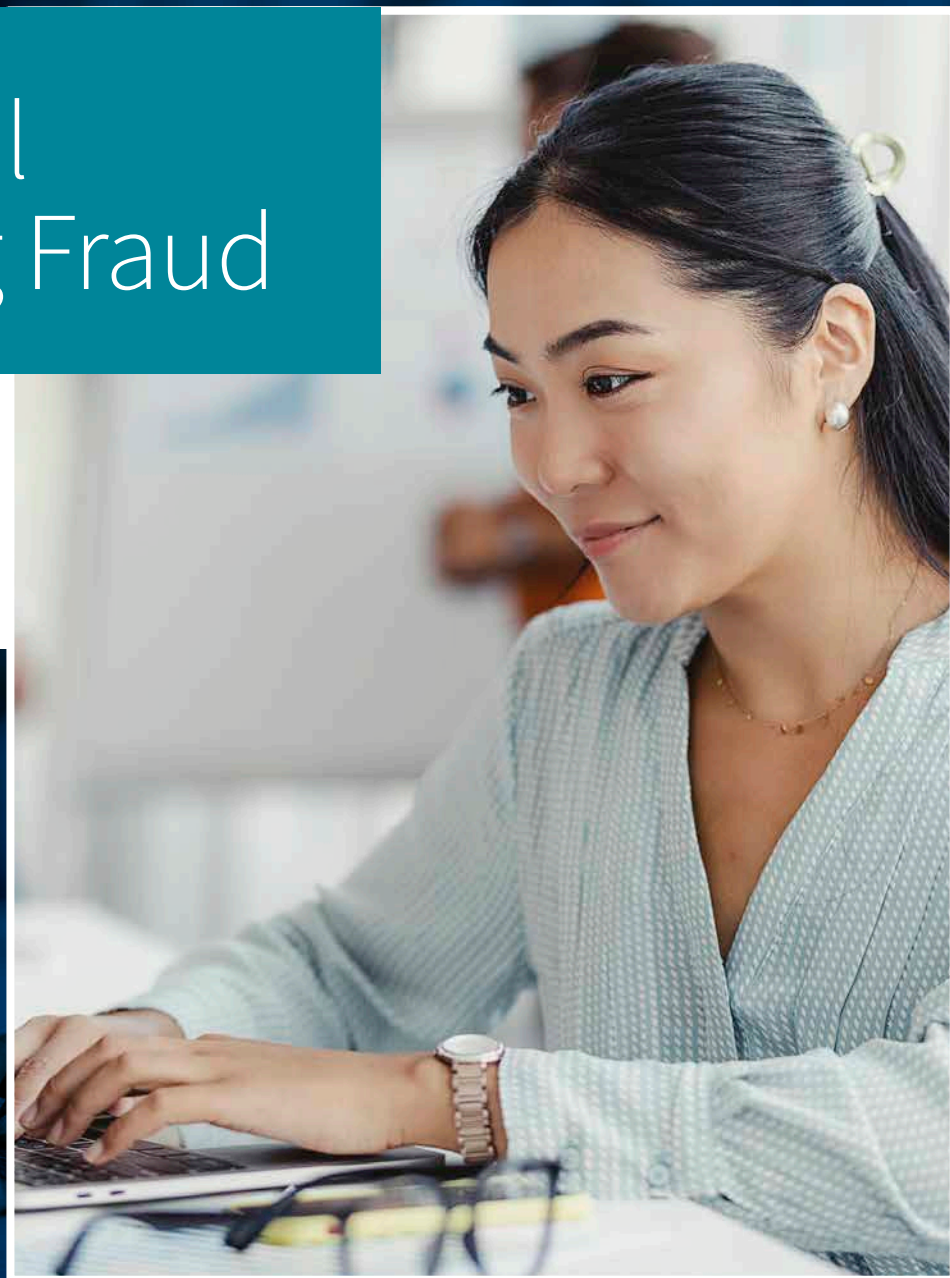


The State of Small Business Lending Fraud

Insights and best practices:
*2021 LexisNexis® Small and Midsize
Business Lending Fraud Study*



Gaining Insight Into Fraud Prevention, Detection and Response

Few businesses escaped unharmed in some way by COVID-19. For small and midsize business (SMB) lenders, one of the most notable consequences was the increase of fraud.

From the very earliest days of the pandemic, bad actors began trying new schemes and methods. And just as it's become clear that COVID isn't going to completely disappear anytime soon, lenders are realizing that fraud too, in its many new and more sophisticated forms, may be here to stay.



LexisNexis® Risk Solutions commissioned a study conducted in August-September 2021 to interview executives from 149 financial institutions that lend to SMBs (defined as earning < \$10 million in annual revenue) to understand:

- **Volume of lending fraud and through which channels**
- **How fraud is identified and tracked**
- **Types of fraud experienced**
- **Priorities, internal activities and levels of investment for curbing fraud**
- **Fraud solutions used**
- **Differences in the above by size or type of organization**



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

While the World Struggled to Handle the COVID-19 Pandemic, Fraudsters Explored New Vulnerabilities to Exploit

SMB lending fraud increased at a higher rate since 2019 and early 2020, costing lenders more as a percent of revenues. The COVID-19 pandemic accounted for over one-third of this increase.



Smaller banks, credit unions and firms with a sizeable volume of digital transactions experienced the **largest year-over-year (YOY) fraud increase**. However, fraud volumes increased for bigger firms as well, especially those processing a sizeable volume of loans through digital channels.



SMB lending fraud as a percent of revenues continues to be highest for fintechs, with **a sizeable 17.6% increase over 2020**.



SMB lending fraud related to **bogus business credentials** and fake or stolen consumer/owner identities increased.



Small banks/credit unions and fintechs were less effective at mitigating risks when they involved fake consumer or owner identities. They **struggled to distinguish synthetic identities from legitimate ones**.



Large banks/credit unions and fintechs struggled when a legitimate business identity was coupled with **fake consumer or owner identity data**.



The risk of fraud was greatest for banks and credit unions that originated a majority of SMB loans via **online/mobile channels**.

COVID-19 Contributed to Increased SMB Lending Fraud and Costs



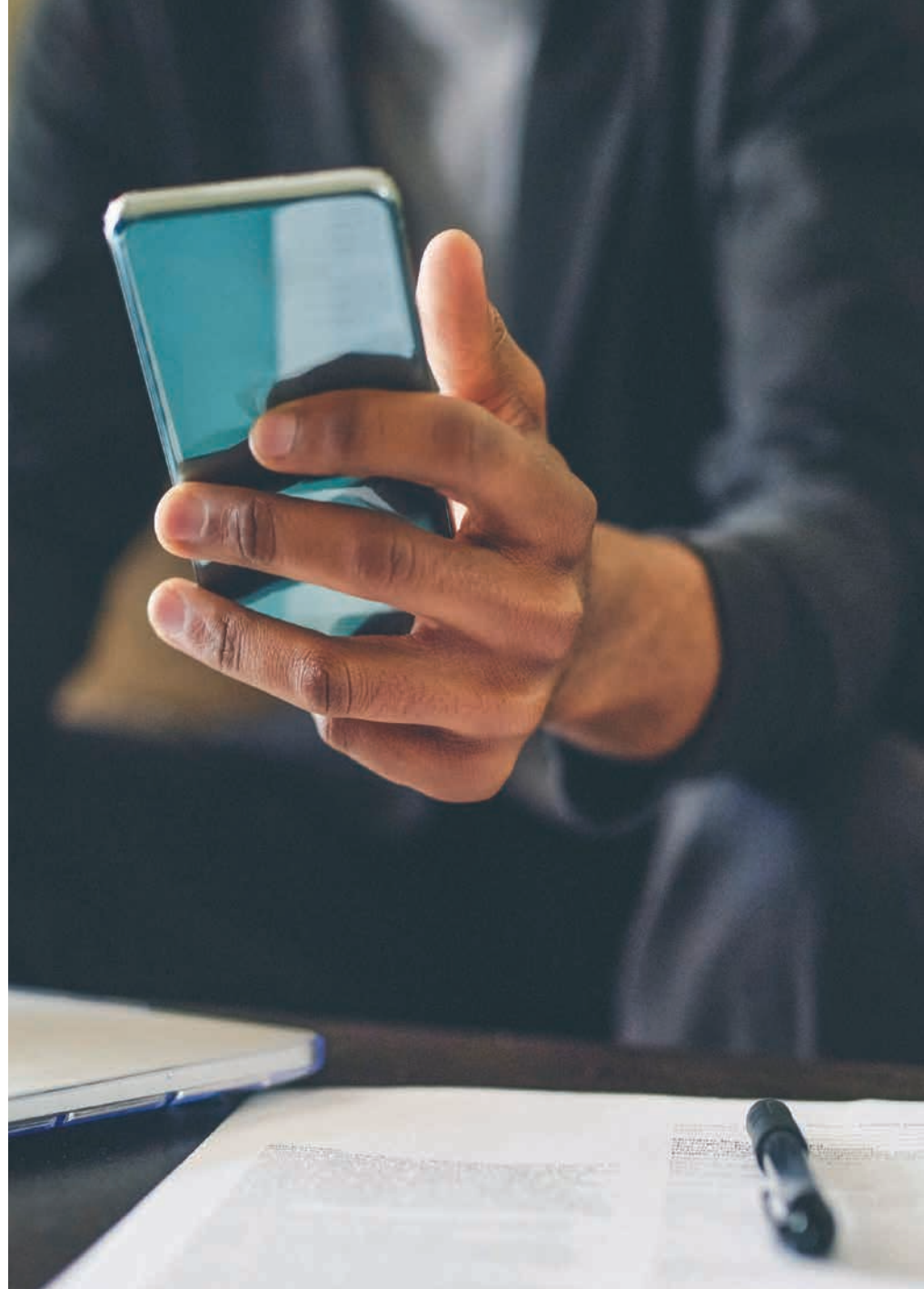
Lenders made only limited use of digital identity solutions that could effectively detect and assess risks from remote channels and the transaction itself.



Complex organizational structures were a barrier to fraud detection.



The majority of financial institutions realized they needed to change their approach to detecting and mitigating SMB lending fraud because of the pandemic. Most chose to invest in labor versus fraud detection solutions.

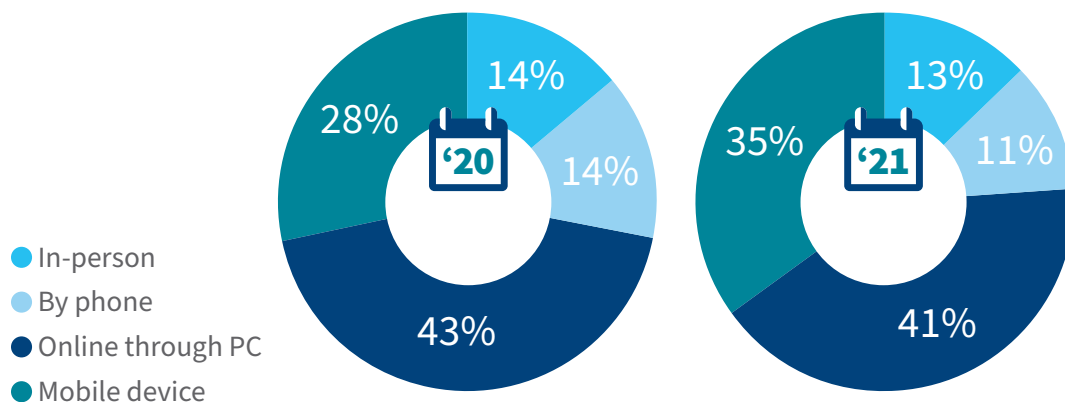


Fraudsters Go Where Customers Are.

Increased Use of the Mobile Channel Drove Increased SMB Lending Fraud.

COVID-19 gave a sizable boost to the use of online and mobile channels among customers and fraudsters as well.

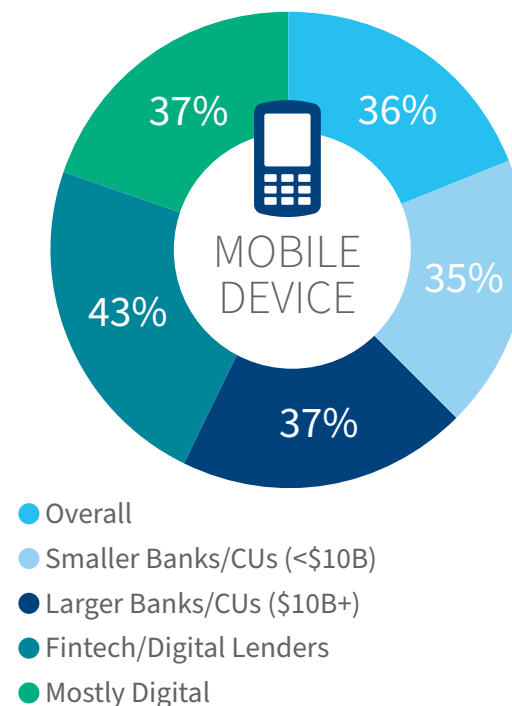
% of SMB loan applications submitted/Loans originated by channel



It's not surprising then that lenders experienced higher fraud losses in the mobile channel, particularly among fintechs and larger banks.

Half of credit lenders and nearly 2/3 of banks indicate a **10% or more increase in the degree of fraud targeting the mobile channel during the past year.**

Distribution of fraud losses via mobile device



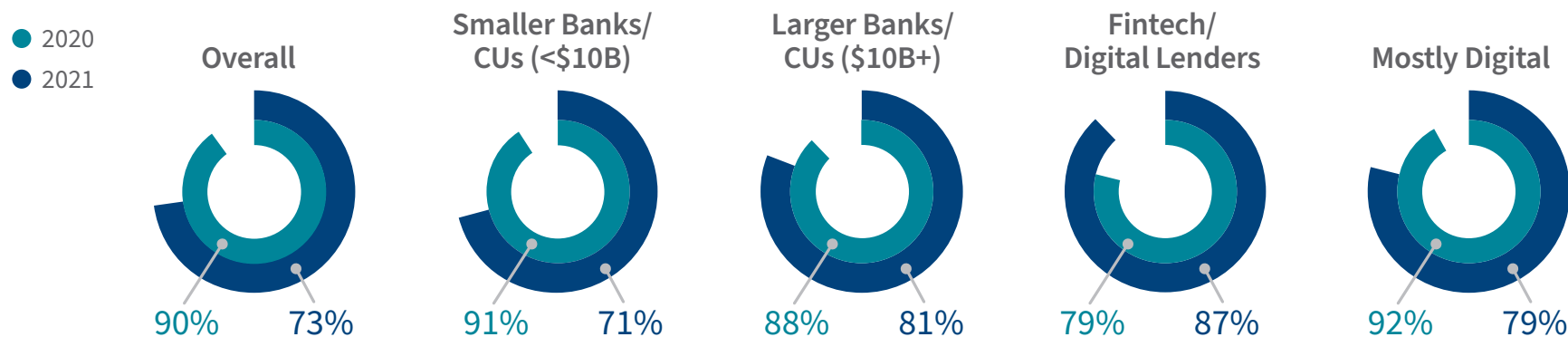
Is Increased Staffing of Fraud Teams the Answer?

Looking ahead, SMB lenders say they expect to increase their investment in fraud mitigation prevention, with a focus on additional labor resources, even though that approach will drive up costs.

Although fintechs are more likely to use fraud mitigation solutions than others, there is still limited use of a multi-layered solutions approach across lending segments that can address fraud risks from different channels and digital behaviors.

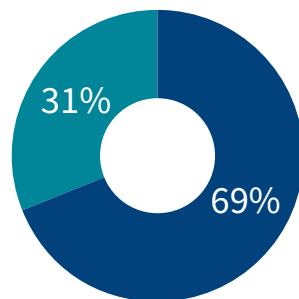
Fewer non-fintechs plan to adjust their strategies from 2020 even though they are battling higher volumes and more complex types of SMB lending fraud.

Firms expecting to increase investments in fraud prevention



Scope of identity verification solutions

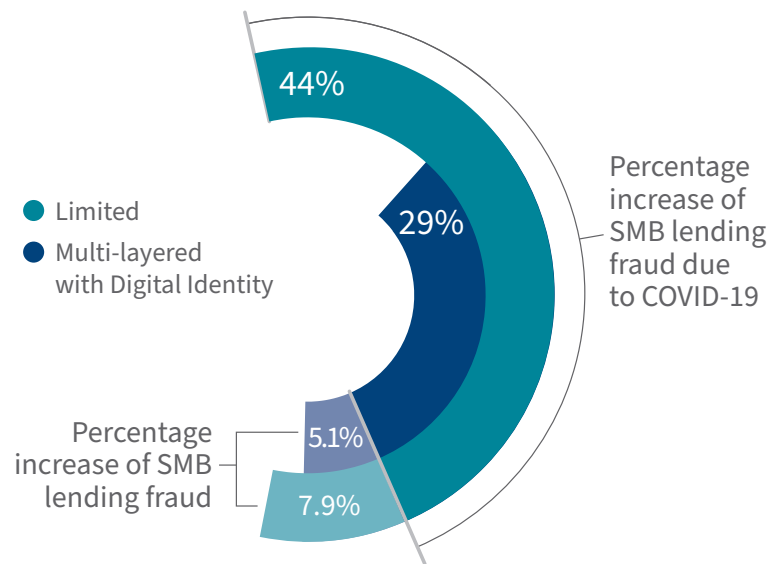
- One Overall Solution
● Multiple Solutions



Overall, there is limited use of solutions that assess individual, device and transaction risks in a behind-the-scenes manner that minimizes customer friction.

A Multi-layered Solutions Approach Works Best

Fraud has become more complex. Various risks can occur at the same time; no single solution can detect them all. To be effective, fraud tools must authenticate both digital and physical criteria, as well as both identity and transaction risk.



Study findings show that lenders which use a multi-layered solutions approach to assess fraud risk by various transaction channels, by physical and digital identity attributes and by transaction, experienced a lower year-over-year increase in SMB lending fraud.

Layering of different solutions to address unique risks from different channels, payment methods and products seemed to work best. And those SMB lenders who went a step farther by integrating capabilities and operations with their fraud prevention efforts experienced a lower rate of fraud overall.

Recommendations



Lenders, large and small, that conduct significant remote channel transactions should use a multi-layered risk solutions approach.



Lending firms with digital channel business models should implement solutions for unique channel issues and fraud. There is no one-size-fits-all solution.



Lenders should seek external providers with deep data and analytics resources to most effectively address identity-based fraud challenges.



Lenders need to remain vigilant by holistically tracking fraud by channel type – noting what has been successful and what was prevented.



To learn more, download the *2021 LexisNexis®
Small and Midsize Business Lending Fraud Study*.

Visit risk.lexisnexis.com/insights-resources/research/smb-lending-fraud-study
or call 800.658.5638.

About LexisNexis® Risk Solutions

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