SECTION 3
Loan Underwriting and Approval

The generation, use, and transmission of information are key components of small business lending, allowing bank decision-makers to identify profitable loans. The consensus of academic research on the loan production process suggests that small and large banks differ in the types of information on which they base loan decisions and the requirements they place on borrowers.[27] However, results from the 2016 SBLS, found in FDIC (2018), show that banks of all sizes typically use similar information in the production of small business loans. The 2022 SBLS delved more deeply into differences in the small business loan-production process, particularly in the types of information gathered and the transmission and use of that information, and how these processes differ by bank size and loan size.

As discussed in Section 1, research on bank lending distinguishes between two types of information: hard and soft. Hard information "is quantitative, is easy to store, and can be transmitted in impersonal ways," while soft information "is difficult to completely summarize in a numeric score, … requires a knowledge of its context to fully understand, and … becomes less useful when separated from the environment in which it was collected."[28] For example, a credit score from a credit bureau is a hard form of information, while a business plan explained to a loan officer is a soft form of information. Banks that rely on hard information can more easily separate information-collection and decision-making tasks, while banks that rely on soft information generally must assign these tasks to one person or a small group of people with specialized knowledge of an industry or geography.[29]

The research also suggests that small banks use more soft information than large banks do.[30] This is typically because smaller banks have a flatter organizational structure, with fewer layers of management or strong and close connections between personnel who gather information and those who make decisions, allowing for easier communication of soft information compared to large banks.[31] Such differences between small and large banks loom large in the context of the consolidation of the banking sector: as large banks make up a collectively larger share of the banking industry, firms that can provide the types of information large banks typically rely on to approve loans may benefit, while firms that cannot may lose access to credit.

To better understand the types of information banks generate, how that information is transmitted, who receives it, and how information may vary across loan sizes at a given bank, the 2022 SBLS contained two sequences of questions about loan underwriting and approval, both of which were keyed to the bank's top lending product, other than credit cards and government-guaranteed loans. The first sequence explored the approval process at banks, including the types of bank personnel involved and how banks delegate approval authority. The second sequence asked about the information banks use to make underwriting decisions for loans of $25,000, $250,000, and $1 million or $3 million, and for what purposes such loans are used.[32]

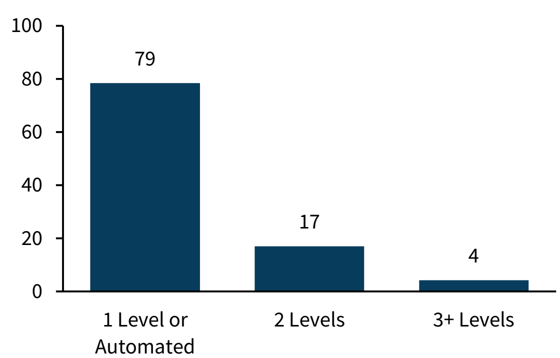
27 See "Relationship and Transactional Lending" in Section 1.
28 Liberti and Petersen (2019).
29 The distinction between soft and hard information can be somewhat malleable. For example, a loan officer might read an applicant's business plan and assign it a numeric rating, thus "hardening" the soft information in the business plan; conversely, the hard numbers in financial statements may require knowledge of the loan applicant's industry in order to understand whether the statements are good or bad.
30 Liberti and Petersen (2019).
31 For example, Berger, Frame, and Miller (2005) find that small banks are better able than large banks to collect and act on soft information. Likewise, Cole, Goldberg, and White (2004) provide evidence suggesting that large banks are more likely than small banks to use standard criteria (i.e., hard information) obtained from financial statements in the loan decision process.
32 Banks were initially asked whether they made loans of $25,000, $250,000, and $1 million or $3 million to small businesses in their normal course of business (as discussed in Section 2). Only banks that made loans of those amounts were asked about their underwriting practices. To reduce survey burden, banks that made $3 million loans were asked about their $3 million loans, while banks that made $1 million loans but not $3 million loans were asked about their $1 million loans.

3.1 Levels of Approval

Small business loan sizes vary widely. The 2022 SBLS documents loans ranging from $25,000 to $3 million (see Section 2). A larger loan will tend to receive more scrutiny as it is a larger amount of money at risk for the lender. In a recent study, loans above $50,000 or $100,000 were found to require more detailed financial information than loans below that amount.[33] The study shows that small business applicants preferred to apply for loans just below the limit than supply the additional information needed for more credit, demonstrating the friction and additional burden created by requiring certain types of information.

To investigate the approval process for different-sized loans to small businesses, the survey asked banks to provide the number of levels of approval for a small and simple small business loan and for a large and complicated small business loan that may have credit policy exceptions.[34] These numbers were used to calculate the minimum and maximum number of levels of approval expected for a small business loan. The results, reported in Figures 3.1 and 3.2, show that 79 percent of banks use a minimum of one level of approval, while 73 percent of banks use three or more levels at a maximum.[35] Few banks (12 percent) have a loan process for small business loans that could require five or more levels of approval.

FIGURE 3.1
Percentage of Banks Reporting Each Minimum Number of Levels of Loan Approval



Source: SBLS 2022 Question I.B6.
Note: Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).

Banks were also asked which factors were likely to influence the number of levels of approval for a loan to a small business. Unsurprisingly, the most commonly reported factor—cited by 80 percent of banks—was loan size (Figure 3.3). The second most commonly reported factor was insufficient debt service coverage ratio, cited by 67 percent of banks. More than half of banks said loan applications from customers outside of the bank's primary lending area (57 percent) or lack of experience lending in the business's industry (53 percent) would influence the levels of approval. Being a repeat customer rarely helped lower the number of levels of approval, with only 21 percent of banks willing to lower the number of levels of approval for a previous deposit relationship and 26 percent for a previous lending relationship.

3.2 Signature Authority and Approver Role

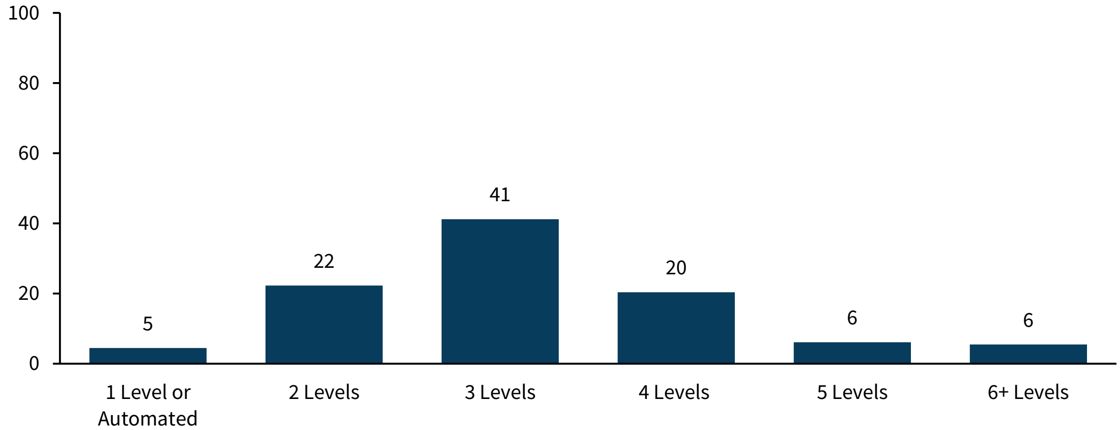
The survey also asked banks about the typical role of approvers (whether the approver is typically a loan officer, senior loan officer, executive, or board member), the typical signature authority (the ability to authorize a loan of a certain size without being subject to higher levels of review) for each level of approval, and whether the approver meets with the applicant.

Responses to the signature authority question provide more context on the above-mentioned finding that large loans undergo more levels of approval than small loans. As shown in Figure 3.4, a very large share of banks (89 percent of small banks and 85 percent of large banks) give signature authority to first-level decision-makers for loans of $25,000. Far fewer banks give first-level decision-makers signature authority for loans of $250,000 or more (43 percent of small banks and 58 percent of large banks).[36]

[33] Witzen (2022).
[34] These questions were keyed to the bank's top lending product other than credit cards and government-guaranteed loans.
[35] Forty-one percent use three levels, 20 percent use four levels, 6 percent use five levels, and 6 percent use six or more levels, summing to 73 percent.
[36] Some banks may skip lower levels of approval for larger loans rather than go through multiple levels of approval, in which case these numbers represent a lower bound on the percentage of banks in which a certain size loan requires only a single reviewer.

FIGURE 3.2

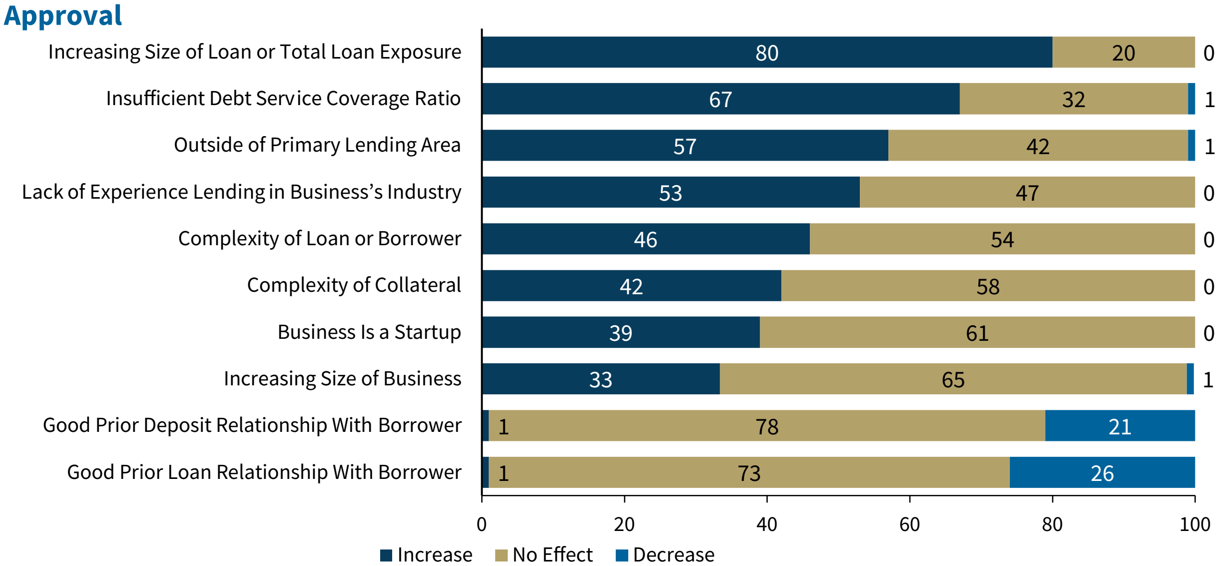
Percentage of Banks Reporting Each Maximum Number of Levels of Loan Approval



Source: SBLS 2022 Question I.B7.
Note: Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).

FIGURE 3.3

Percentage of Banks Citing Selected Factors as Influencing Number of Levels of Loan Approval



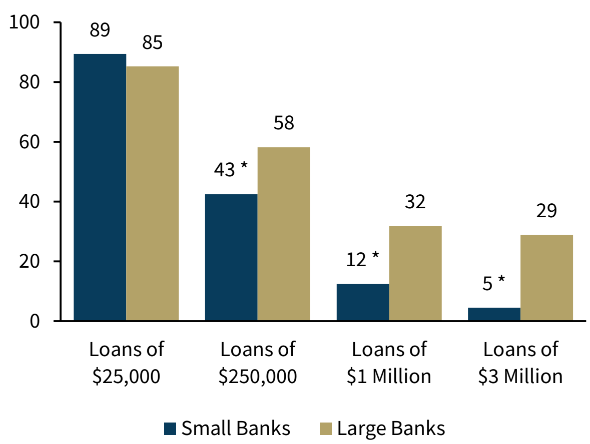
Source: SBLS 2022 Question I.B5.
Note: Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information). Results may not sum to 100 percent due to rounding.

Signature authority for loans of $1 million or more is sharply different at small and large banks. Only one in eight small banks typically give signature authority to first-level decision-makers for loans of $1 million or more, compared with nearly a third of large banks (Figure 3.4). For nearly half of small banks, the first two levels in the bank's approval structure typically lack signature authority for a $1 million loan, compared with only one in eight large banks (Figure 3.5). This finding is unsurprising since a $1 million loan is a larger share of assets to a small bank than to a large bank and thus may merit a larger degree of scrutiny.

Small banks are much more likely than large banks to have an executive or the board of directors involved in the approval of small business loans. Figure 3.6 shows that 76 percent of small banks involve an executive in decision-making for small business loans and 62 percent involve a board member or the board as a whole if the loan is sufficiently large and complex. The shares are sharply lower at large banks: 42 percent of large banks involve an executive and 9 percent involve a board member in

FIGURE 3.4

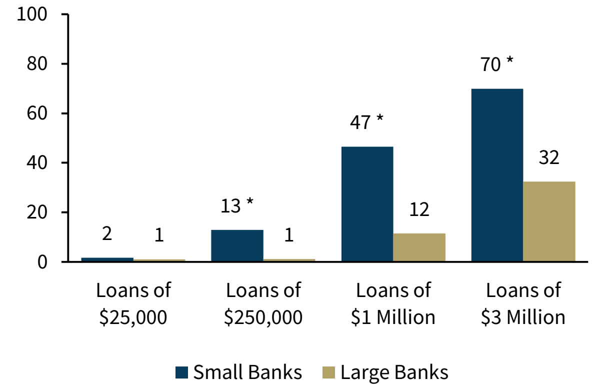
Percentage of Banks Vesting Signature Authority for Various Loan Sizes With the First Level of Loan Approval, by Bank Size



Source: SBLS 2022 Questions I.B12 and I.B13.
Note: Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).
* Denotes a statistically significant difference between small and large banks at the 10 percent level.

FIGURE 3.5

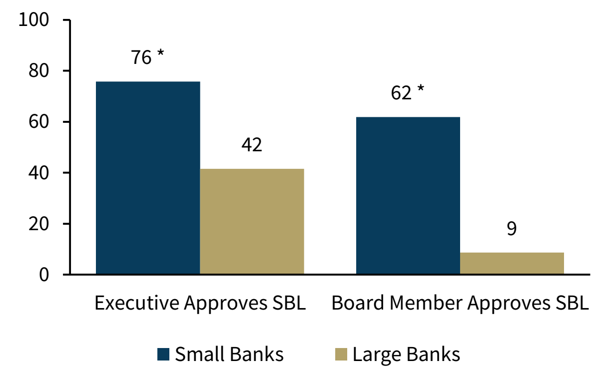
Percentage of Banks Vesting Signature Authority for Various Loan Sizes With the Third or Higher Level of Loan Approval, by Bank Size



Source: SBLS 2022 Questions I.B22, I.B23, I.B27, and I.B28.
Note: Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).
* Denotes a statistically significant difference between small and large banks at the 10 percent level.

FIGURE 3.6

Percentage of Banks Where Some Small Business Loans Are Approved by Executives or Board Members, by Bank Size



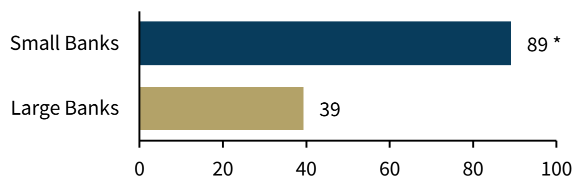
Source: SBLS 2022 Questions I.B9, I.B10, I.B14, I.B15, I.B19, I.B20, I.B24, and I.B25.
Note: Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).
* Denotes a statistically significant difference between small and large banks at the 10 percent level.

the decision-making for small business loans. These findings provide some nuance to the conventional wisdom that small banks have flatter organizational structures than large banks. Although senior managers at small banks are closer to the inner workings of small business lending, small banks still may have more levels of approval for larger loans.

3.3 Meetings Between Decision-Makers and Applicants

One way small banks seem to have a flatter organizational structure than large banks is in the way they gather information. Small banks are much more likely than large banks to have meetings directly between small business loan applicants and decision-makers. Nearly 90 percent of small banks meet with applicants, compared with less than 40 percent of large banks (Figure 3.7). These meetings may allow small banks to lend more flexibly, particularly to start-up businesses (see Section 7), since the meetings may yield valuable soft information that can compensate for a lack of hard information. In-person meetings, as opposed to virtual meetings or teleconferences, further emphasize the importance of banks' proximity to small business borrowers (discussed further in Section 5).

FIGURE 3.7
Percentage of Banks Where Decision-Makers Meet With the Loan Applicant at Some Level of Approval, by Bank Size



Source: SBLS 2022 Questions I.B11, I.B16, I.B21, and I.B26.
Note: Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).
* Denotes a statistically significant difference between small and large banks at the 10 percent level.

Bank size and meetings are negatively correlated across broad categories of small and large banks (Figure 3.8). Ninety-five percent of banks with less than $500 million in assets meet with applicants, compared with only 65 percent of banks with $3 billion to $10 billion in assets. Among the largest banks—those with more than $50 billion in assets—the practice of meeting with applicants is fairly rare, used by less than a quarter of such banks. These findings are concerning within the context of the trend in bank consolidation. As banks become larger, fewer small businesses will have the opportunity to make their case directly to decision-makers.

3.4 Length of Time to Loan Approval

A bank's decision-making structure may influence how long it takes for loans to be approved, which is important to borrowers. Small businesses place a high premium on speed in lending; according to surveyed banks, lending speed is second only to customer service in importance to small business borrowers (see Section 6.5). The Federal Reserve Banks' 2016 Small Business Credit Survey found that a long wait for loan approval was one of the most frequent issues small businesses face when looking for credit.[37]

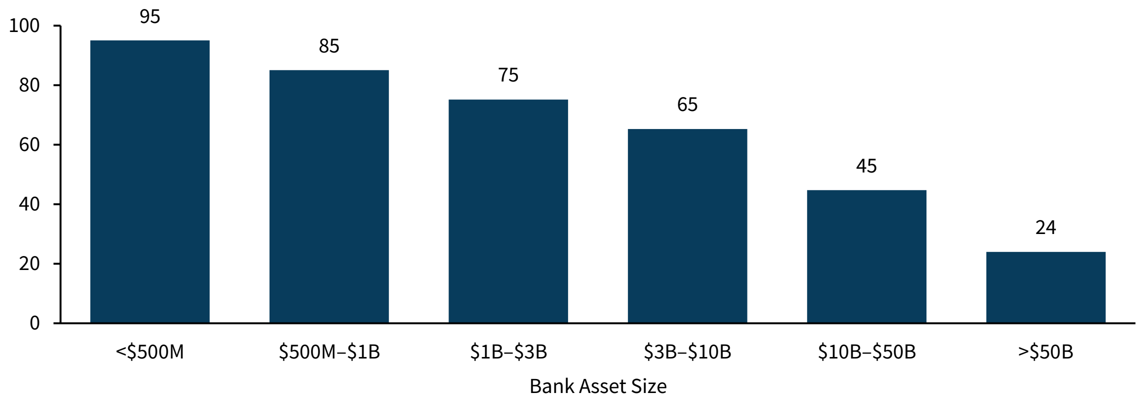
The 2022 SBLS asked banks about the typical minimum approval time for a small and simple loan and a large and complex loan, as well as the overall typical approval time.[38] The survey also asked banks to report factors that influence approval times.

Most banks approve small and simple loans quickly; more than three-quarters of banks report they can approve these loans in a week or less (Figure 3.9). Three-quarters of banks report that they approve the typical small business loan in two weeks or less (Figure 3.10). Approval for a very large or complex loan can take four to six weeks (Figure 3.11).

[37] Federal Reserve Banks (2017). This report focuses on microbusinesses which it defines as small businesses with four or fewer employees.
[38] As before, the survey questions were keyed to the bank's top product other than credit cards or government-guaranteed loans, so the lower-end approval times are not due to credit cards.

FIGURE 3.8

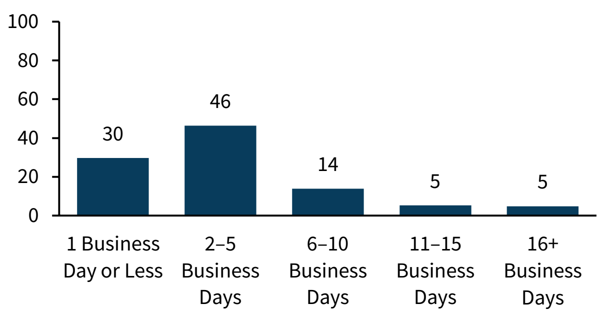
Percentage of Banks Where Decision-Makers Meet With the Loan Applicant at Some Level of Approval, by Disaggregated Bank Size



Source: SBLS 2022 Questions I.B11, I.B16, I.B21, and I.B26.
Note: Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).

FIGURE 3.9

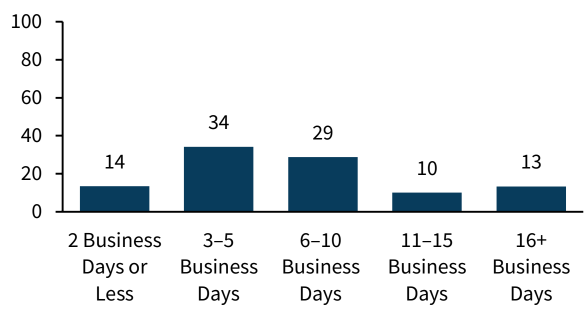
Percentage of Banks Reporting Each Minimum Number of Business Days Until Loan Approval



Source: SBLS 2022 Question I.B2.
Note: Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).

FIGURE 3.10

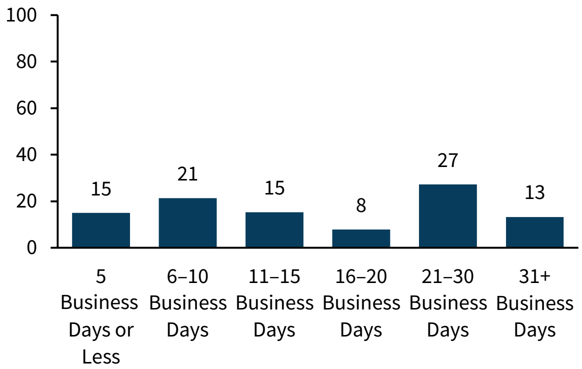
Percentage of Banks Reporting Each Typical Number of Business Days Until Loan Approval



Source: SBLS 2022 Question I.B4.
Note: Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).

FIGURE 3.11

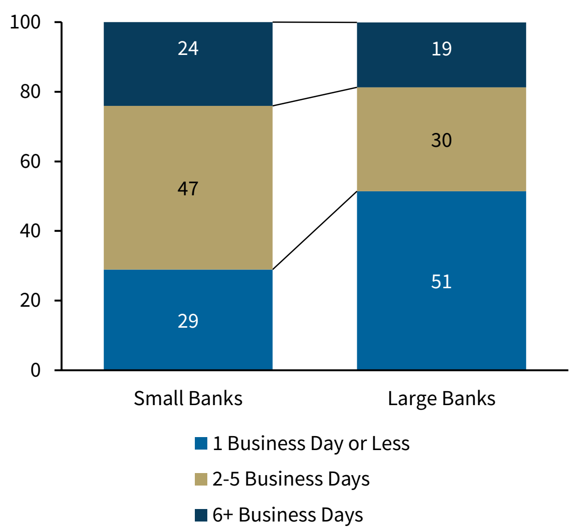
Percentage of Banks Reporting Each Maximum Number of Business Days Until Loan Approval



Source: SBLS 2022 Question I.B3.
Note: Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information). Results may not sum to 100 percent due to rounding.

FIGURE 3.12

Percentage of Banks Reporting Each Minimum Number of Business Days Until Loan Approval, by Bank Size



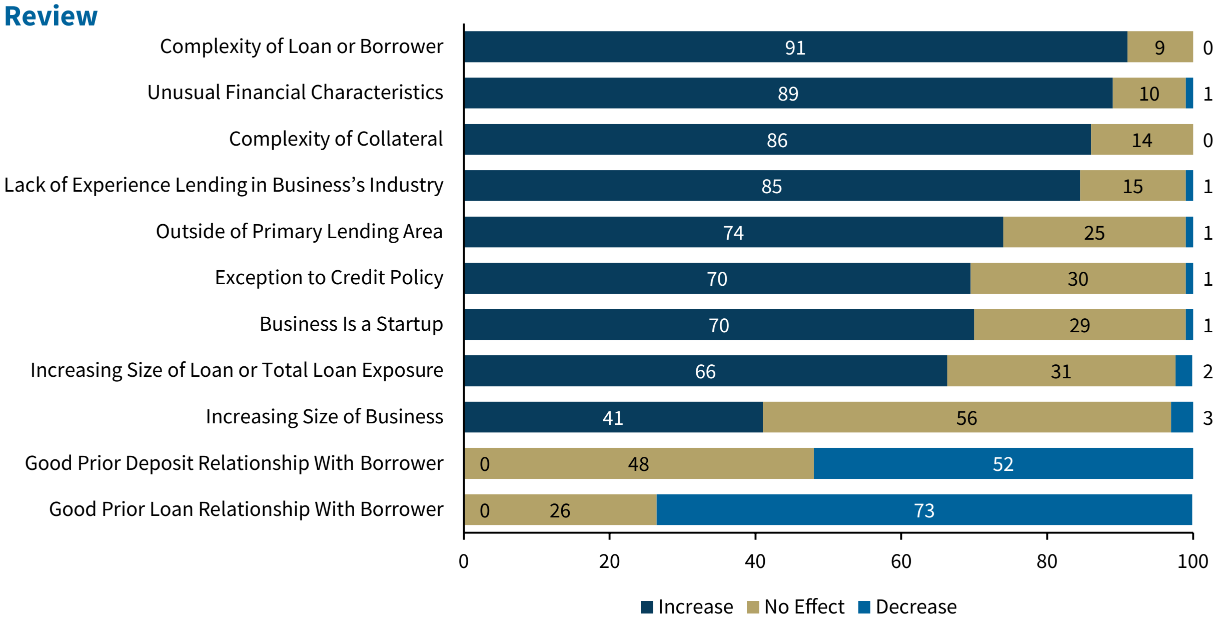
Source: SBLS 2022 Question I.B2.
Note: Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).

The most notable difference in decision speed between small and large banks is in the minimum number of business days required to approve a loan. Slightly more than half of large banks can approve a small and simple loan in one business day or less, compared with only 29 percent of small banks (Figure 3.12).

This speed advantage may be due to the greater use of automated lending technology by large banks or their increased reliance on hard credit-scoring information, discussed later in this section. Further, this advantage exists only at the single-day margin; roughly equal proportions of small and large banks—76 percent of small banks and 81 percent of large banks—can approve a small and simple loan in less than a week.

A variety of factors determine how long it takes for a loan to be approved (Figure 3.13). Chief among them are the complexity of the loan or borrower and whether the loan has unusual characteristics, both of which cause delays in the approval process for about 90 percent of banks. Applications from businesses in a geographic area or industry unfamiliar to the bank also take longer to review for a substantial majority of banks. Notably, having a past loan relationship with the borrower speeds up the approval process at nearly three-quarters of banks, despite findings in this section that past relationships rarely lower the number of levels of approval.

FIGURE 3.13
Percentage of Banks Citing Selected Factors as Influencing the Duration of Loan Application Review



Source: SBLS 2022 Question I.B1.
Note: Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information). Results may not sum to 100 percent due to rounding.

3.5 What Information Do Banks Use in Underwriting?

The results in this section have shown that the size of the loan and the size of the bank influence who is involved in the decision-making process and how quickly loan decisions are made. The rest of this section discusses how banks gather, process, and prioritize the information that leads to a loan approval decision and how these steps differ based on the confluence of bank and loan size.

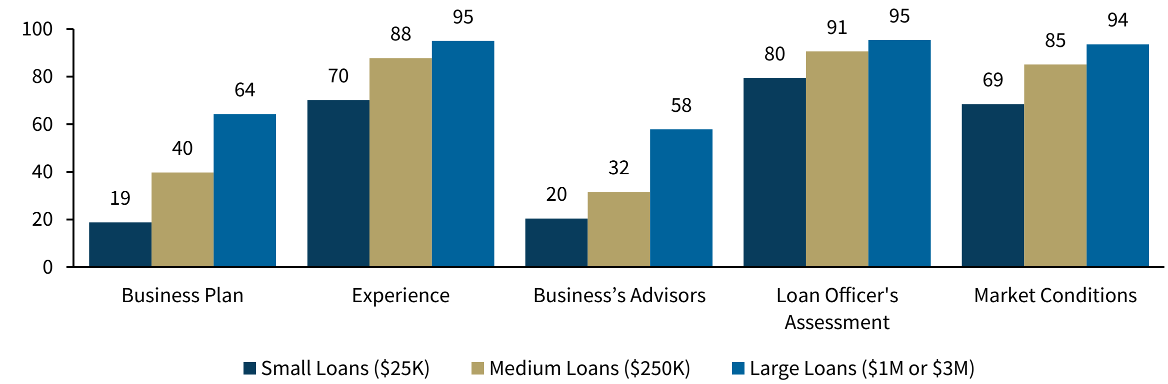
Much of this subsection focuses on the distinction between soft and hard information, particularly how banks of different sizes use these information types for loans of different amounts. As previously discussed, soft information is highly contextual and difficult to reduce to a simple numeric score, while hard information is quantitative and does not change in meaning when it is divorced from context. Banks may be reluctant to lend to certain small businesses because these businesses lack hard information, such as a business credit rating or a personal credit score for the owner. Thus, if lending based on soft information or on relationships becomes less common, businesses that lack hard information may have a more difficult time obtaining credit.

The survey asked banks how commonly they use 12 types of information, ranging from hard information such as credit scores to soft information such as loan officer interviews, when evaluating small business loan applications. Banks were asked whether they evaluate each type of information for "no or almost no," "some," "most," or "almost all or all" loans. The question was asked separately for loans of $25,000 (small loans), $250,000 (medium loans), and $1 million or $3 million (large loans).

Figure 3.14 shows the percentage of banks that evaluate each of the soft information types for most or all loans of each size, and Figure 3.15 shows the percentage of banks that evaluate each of the hard information types for most or all loans of each size. The figures illustrate that banks use a variety of information to evaluate loan applications. For example, for medium loans, banks evaluate an average of 8 of the 12 types of information for most or all loans. The most commonly evaluated types of information are personal credit scores and willingness to offer collateral or guarantees, which more than 80 percent of banks evaluate for most or all of their loans, regardless of size. For large loans, non-audited financial statements, the experience of

FIGURE 3.14

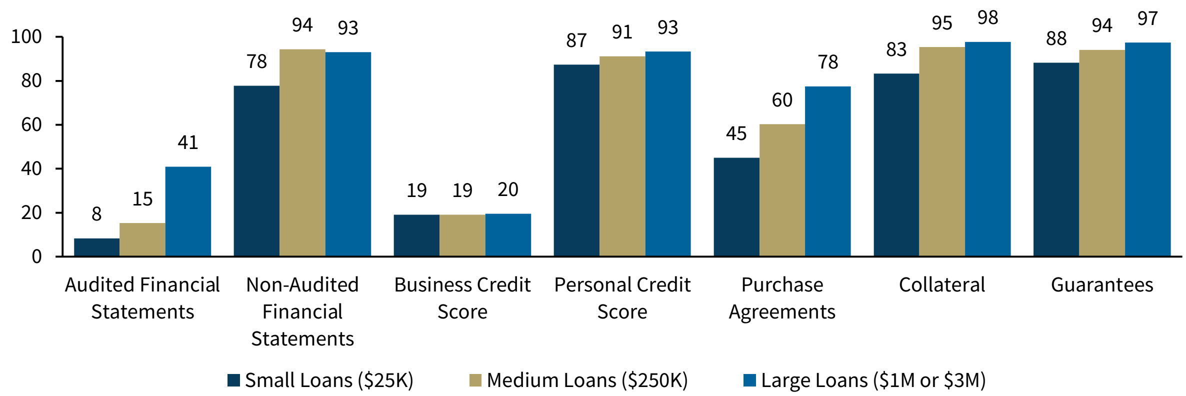
Percentage of Banks Evaluating Each Type of Soft Information in Loan Applications for Various Loan Sizes



Source: SBLS 2022 Questions I.C4, I.C10, and I.C16.
Note: Results reflect a response of either "evaluates for most loans of this size" or "evaluates for all loans of this size." Responses were combined to form the "large loan" category. Banks that made $3 million loans were asked about their $3 million loans, whereas banks that made $1 million loans but not $3 million loans were asked about their $1 million loans. Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).

FIGURE 3.15

Percentage of Banks Evaluating Each Type of Hard Information in Loan Applications for Various Loan Sizes



Source: SBLS 2022 Questions I.C4, I.C10, and I.C16.
Note: Results reflect a response of either "evaluates for most loans of this size" or "evaluates for all loans of this size." Responses were combined to form the "large loan" category. Banks that made $3 million loans were asked about their $3 million loans, whereas banks that made $1 million loans but not $3 million loans were asked about their $1 million loans. Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).

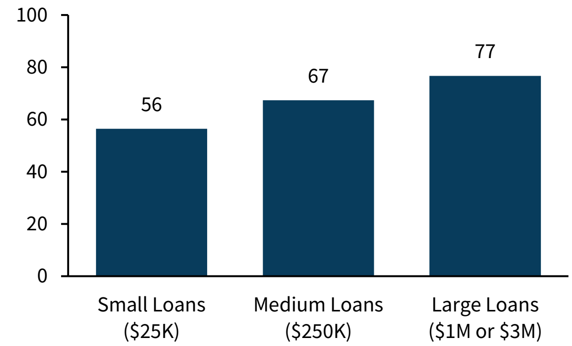
the owner or management team, the assessment of a loan officer, and market conditions are all commonly evaluated, with more than 90 percent of banks evaluating them for most or all large loans. By contrast, the least-commonly evaluated types of information are business credit scores and audited financial statements, although 41 percent of banks use audited financial statements to evaluate large loans.

The findings in Figures 3.14 and 3.15 suggest a pattern of increasing information use for higher loan sizes. To quantify this pattern and to examine how the use of soft and hard information differs among banks, three "information scores" were constructed for each bank size and loan size: a hard information score incorporating the information types from Figure 3.15, a soft information score incorporating the information types from Figure 3.14, and an overall information score incorporating all information types. These scores take a theoretical minimum of zero and a theoretical maximum of 100, so that a score of zero for overall information indicates that a bank never uses any of the 12 types of information and a score of 100 indicates that a bank uses all 12 types of information for all or almost all loans of a given size.[39]

Aggregate information use based on the overall information score illustrates two key findings. First, as loan size increases, the amount of information that banks evaluate increases. Figure 3.16 shows that the average overall information score for a small loan is 56, roughly equivalent to using 7 out of 12 types of information for all small loans. In contrast, the average overall information score for a large loan is 77, roughly equivalent to using 9 out of 12 types of information for all large loans. Second, small banks consistently use more information than large banks, with a gap of 7 to 10 points in the overall information score depending on the size of loan (Figure 3.17). Both findings are consistent with the idea that banks gather more information as they put more of their assets at risk.

FIGURE 3.16

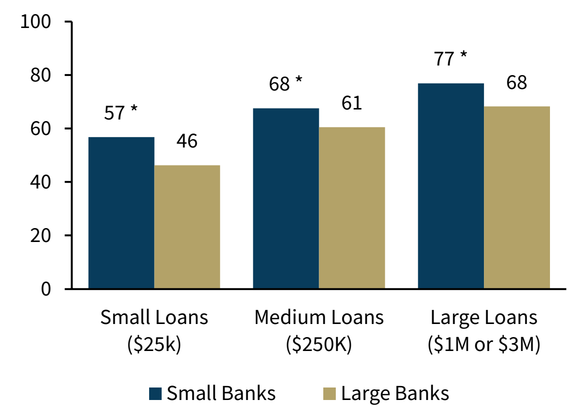
Average Information Score for Various Loan Sizes



Source: SBLS 2022 Questions I.C4, I.C10, and I.C16.
Note: Information score is described in Appendix A.6. Responses were combined to form the "large loan" category. Banks that made $3 million loans were asked about their $3 million loans, whereas banks that made $1 million loans but not $3 million loans were asked about their $1 million loans. Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).

FIGURE 3.17

Average Information Score for Various Loan Sizes, by Bank Size

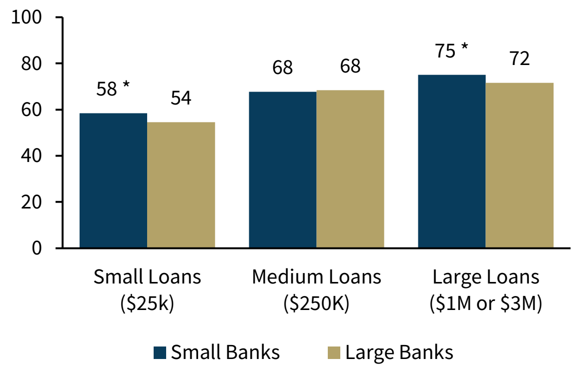


Source: SBLS 2022 Questions I.C4, I.C10, and I.C16.
Note: Information score is described in Appendix A.6. Responses were combined to form the "large loan" category. Banks that made $3 million loans were asked about their $3 million loans, whereas banks that made $1 million loans but not $3 million loans were asked about their $1 million loans. Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).
* Denotes a statistically significant difference between small and large banks at the 10 percent level.

[39] See Appendix A.6 for a more detailed explanation of how the information score was constructed.

FIGURE 3.18

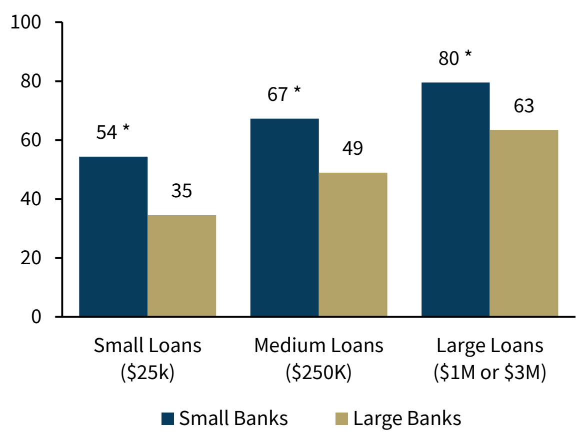
Average Hard Information Score for Various Loan Sizes, by Bank Size



Source: SBLS 2022 Questions I.C4, I.C10, and I.C16.
Note: Information score is described in Appendix A.6. Responses were combined to form the "large loan" category. Banks that made $3 million loans were asked about their $3 million loans, whereas banks that made $1 million loans but not $3 million loans were asked about their $1 million loans. Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).
* Denotes a statistically significant difference between small and large banks at the 10 percent level.

FIGURE 3.19

Average Soft Information Score for Various Loan Sizes, by Bank Size



Source: SBLS 2022 Questions I.C4, I.C10, and I.C16.
Note: Information score is described in Appendix A.6. Responses were combined to form the "large loan" category. Banks that made $3 million loans were asked about their $3 million loans, whereas banks that made $1 million loans but not $3 million loans were asked about their $1 million loans. Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).
* Denotes a statistically significant difference between small and large banks at the 10 percent level.

Separating the information score between small and large banks and between soft and hard information (Figures 3.18 and 3.19) shows that small banks use more soft information than large banks do, which supports the consensus view of small banks as relationship lenders. The gap between small and large banks in their use of hard information is small and only sometimes statistically significant, while the gap in use of soft information ranges from 15 to 20 points depending on loan size. The willingness and ability of small banks to harness soft information may also be related to their greater lending flexibility and their ability to lend to marginal borrowers, including start-ups (see Section 6 and Section 7).

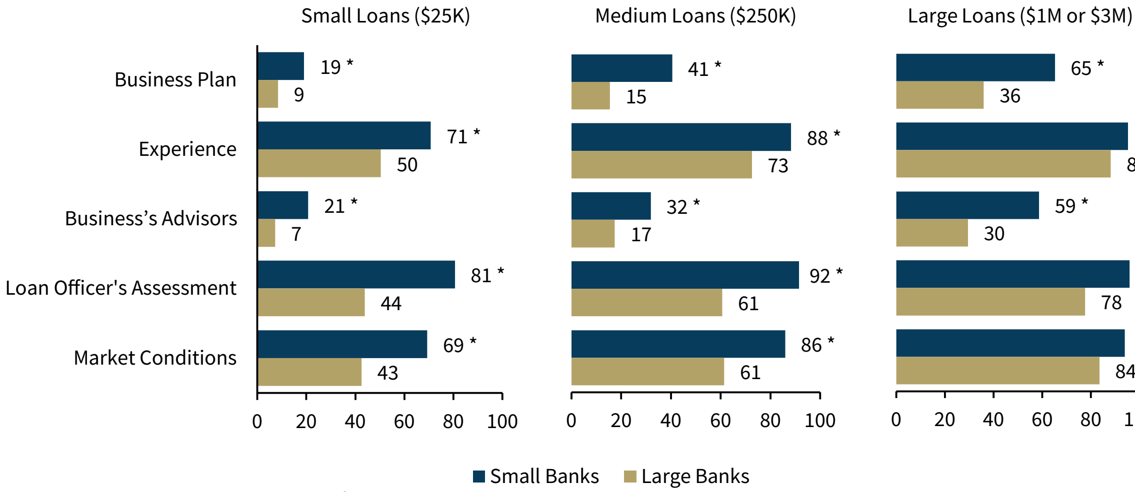
Small banks use a variety of soft information and are more likely than large banks to evaluate each of the five types of soft information for all three loans sizes. The gap is particularly large for loan officer's assessments of small loans: 81 percent of small banks use this information for all or almost all of their small loans, compared with 44 percent of large banks (Figure 3.20).

One of the most noticeable differences between small and large banks in their use of hard information is that large banks consistently evaluate business credit scores more than small banks do. For all loan sizes, less than 20 percent of small banks evaluate business credit scores for most or all small business loans, compared with more than half of large banks (Figure 3.21). Large banks also use business credit scores slightly more often for small loans than for large loans: 62 percent of large banks use business credit scores for most or all small loans and 55 percent use credit scores for most or all large loans. It is not necessarily the case that small banks are uninterested in the information in business credit scores, however; instead, small bank borrowers may be less likely than large bank borrowers to have business credit scores to evaluate. This possibility is supported by the fact that small banks are more likely than large banks to lend to start-ups (see Section 7).

Banks may manage the risk of lending to small businesses by requiring collateral, which both increases the borrower's incentive to repay the bank by increasing the cost of default and reduces the bank's losses in the event of default. To investigate the importance of collateral, the survey asked banks how commonly they *evaluate* collateral and how often they *require* collateral for loans of different

FIGURE 3.20

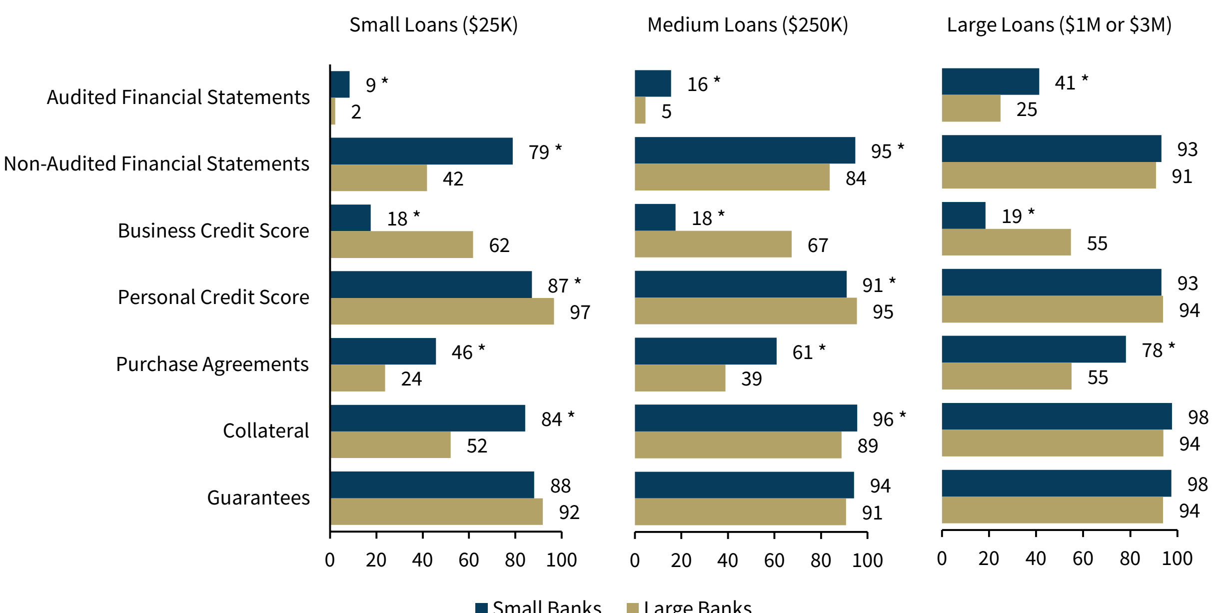
Percentage of Banks Evaluating Each Type of Soft Information in Loan Applications for Various Loan Sizes, by Bank Size



Source: SBLS 2022 Questions I.C4, I.C10, and I.C16.
Note: Results reflect a response of either "evaluates for most loans of this size" or "evaluates for all loans of this size." Responses were combined to form the "large loan" category. Banks that made $3 million loans were asked about their $3 million loans, whereas banks that made $1 million loans but not $3 million loans were asked about their $1 million loans. Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).
* Denotes a statistically significant difference between small and large banks at the 10 percent level.

FIGURE 3.21

Percentage of Banks Evaluating Each Type of Hard Information in Loan Applications for Various Loan Sizes, by Bank Size

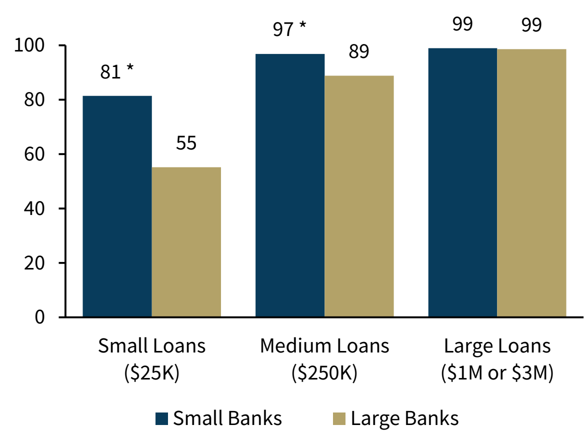


Source: SBLS 2022 Questions I.C4, I.C10, and I.C16.
Note: Results reflect a response of either "evaluates for most loans of this size" or "evaluates for all loans of this size." Responses were combined to form the "large loan" category. Banks that made $3 million loans were asked about their $3 million loans, whereas banks that made $1 million loans but not $3 million loans were asked about their $1 million loans. Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).
* Denotes a statistically significant difference between small and large banks at the 10 percent level.

amounts ("rarely or never," "sometimes," "often," or "almost always or always"). While the two practices are related, they are not entirely synonymous: a bank may evaluate collateral for a loan without necessarily requiring that the borrower provide collateral for that loan. Figure 3.21 shows that large banks are far less likely than small banks to *evaluate* collateral for small loans: 84 percent of small banks compared with 52 percent of large banks. As shown in Figure 3.22, shares are similar for banks that often or always *require* collateral for small loans (81 percent of small banks and 55 percent of large banks). For large loans, however, evaluating collateral during underwriting is a near-ubiquitous practice for both small and large banks, and almost all small and large banks often or always require it for medium and large loans.

The tendency to require collateral for small loans may highlight differences in the types of small business borrowers that typically obtain credit at small and large banks. If the practice by large banks of emphasizing hard information when underwriting facilitates looser collateral requirements, then large banks may be better positioned to serve established small businesses that have relatively little access to usable collateral (for example, firms whose capital is in the form of intellectual property rather than physical capital). Conversely, by generally requiring collateral but evaluating comparatively more soft information for small loans, small banks may be better situated to lend to small businesses which are less established but that do have access to collateral.[40] To the extent that the U.S. economy has small business borrowers of both types, the market for small business loans, though segmented across different-sized banks, appears diverse enough to meet the varied needs of small businesses.

FIGURE 3.22
Percentage of Banks Requiring Collateral for Various Loan Sizes, by Bank Size



Source: SBLS 2022 Questions I.C5, I.C11, and I.C17.
Note: Results reflect a response of either "often requires collateral for loans of this size" or "always or almost always requires collateral for loans of this size." Responses were combined to form the "large loan" category. Banks that made $3 million loans were asked about their $3 million loans, whereas banks that made $1 million loans but not $3 million loans were asked about their $1 million loans. Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).
* Denotes a statistically significant difference between small and large banks at the 10 percent level.

3.6 Which Aspects of a Loan Application Are Important for Approval?

In addition to asking about information use, the survey asked banks to rank the following six aspects of a loan application by their importance:

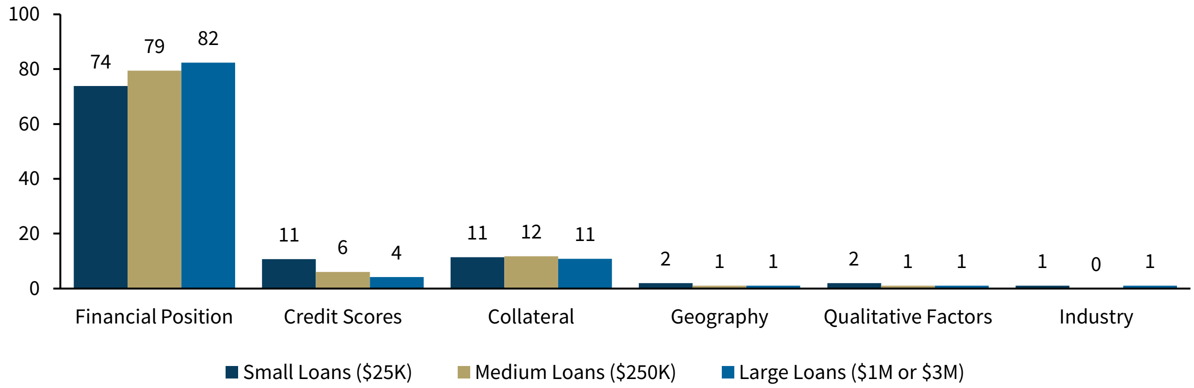
1. the business's financial position (e.g., balance sheet, debt-service coverage ratio, and liquidity management)
2. credit scores or other information from credit bureaus about the business or owner
3. the geographic proximity of the business to the bank
4. the presence or quality of collateral and guarantees offered by the business or owner
5. the industry of the business
6. qualitative factors such as the business plan or the experience of the owner or management team.

Banks ranked the six aspects from first to last for each of the three loan sizes (small, medium, and large).

Most small banks—74 to 82 percent—consider the business's financial position the most important aspect of a loan application, regardless of loan size

[40] These practices are not necessarily unrelated, and the use of soft information may well underpin the perceived competitive advantage of small banks in flexibility over collateral requirements (see Section 6).

FIGURE 3.23
Percentage of Small Banks Citing Each Aspect as Most Important in Loan Applications for Various Loan Sizes



Source: SBLS 2022 Questions I.C8, I.C14, and I.C20.
Note: Responses were combined to form the "large loan" category. Banks that made $3 million loans were asked about their $3 million loans, whereas banks that made $1 million loans but not $3 million loans were asked about their $1 million loans. Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).

(Figure 3.23). Collateral or guarantees are the most important consideration for 11 to 12 percent of small banks, and credit bureau information is the most important for 4 to 11 percent.[41] Almost no small banks view geography, industry, or qualitative factors as the most important aspect of any size loan.

There are no meaningful differences between large and small banks in the aspects of an application they consider most important for approving a large loan. But large banks are far more likely than small banks to view credit bureau information, not financial position, as the most important aspect of an application for a small loan (59 percent versus 11 percent, see Figure 3.23 and Figure 3.24). Even for medium loans, 31 percent of large banks place more importance on credit bureau information than on financial position.

These results reinforce earlier findings in this section that small banks tend to make small loans based more on soft information and large banks tend to make small loans based on a smaller amount of hard information.

3.7 Automated Underwriting

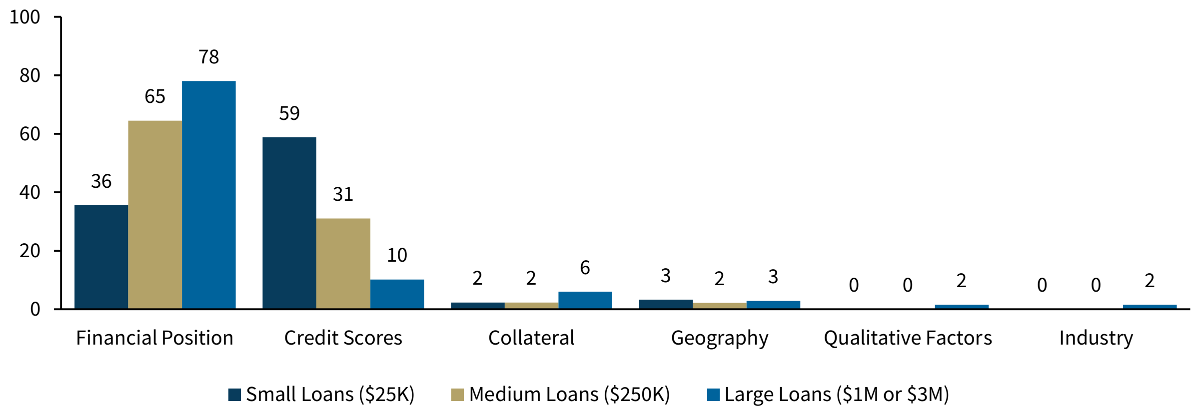
The reliance of large banks on hard information to make small loans is consistent with the greater use of automated underwriting by large banks. Automated underwriting—the practice of using a credit-scoring model to produce a lending decision based only on numeric inputs without human discretion—is the most extreme form of transactional, hard-information-based lending.

The survey asked banks if they used a credit-scoring model to automate the lending process and, if so, what size loans the model could automatically approve. The survey finds that large banks are much more likely than small banks to use some form of automated underwriting (auto-approval, auto-denial, or both). As shown in Figure 3.25, only 9 percent of small banks use a credit-scoring model, compared with 46 percent of large banks. However, even for large banks, use of credit-scoring models is generally confined to small loans. While 28 percent of all large banks would auto-approve a small loan, only 11 percent would auto-approve a medium loan and a mere 1 percent would auto-approve a large loan (Figure 3.26). These results support previous findings of a divide between small and large banks in how they underwrite smaller loans.

41 Although collateral was not the most important aspect for most small or large banks, it consistently ranked in the top three aspects for both small and large banks for all loan sizes.

FIGURE 3.24

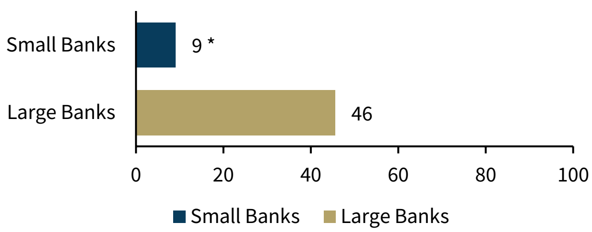
Percentage of Large Banks Citing Each Aspect as Most Important in Loan Applications for Various Loan Sizes



Source: SBLS 2022 Questions I.C8, I.C14, and I.C20.
Note: Responses were combined to form the "large loan" category. Banks that made $3 million loans were asked about their $3 million loans, whereas banks that made $1 million loans but not $3 million loans were asked about their $1 million loans. Question is keyed to the bank's highest-volume small business lending product, excluding credit cards and government-guaranteed products (see Appendix A for more information).

FIGURE 3.25

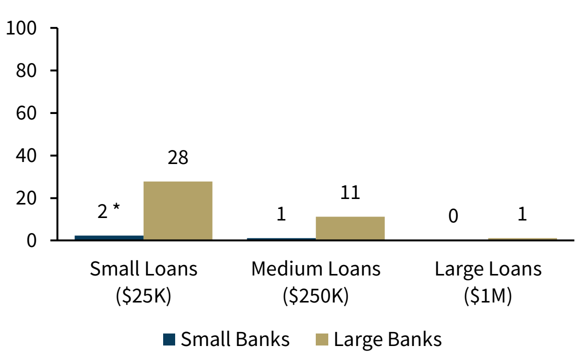
Percentage of Banks Using a Credit Scoring Model for Small Business Lending, by Bank Size



Source: SBLS 2022 Question I.D1.
* Denotes a statistically significant difference between small and large banks at the 10 percent level.

FIGURE 3.26

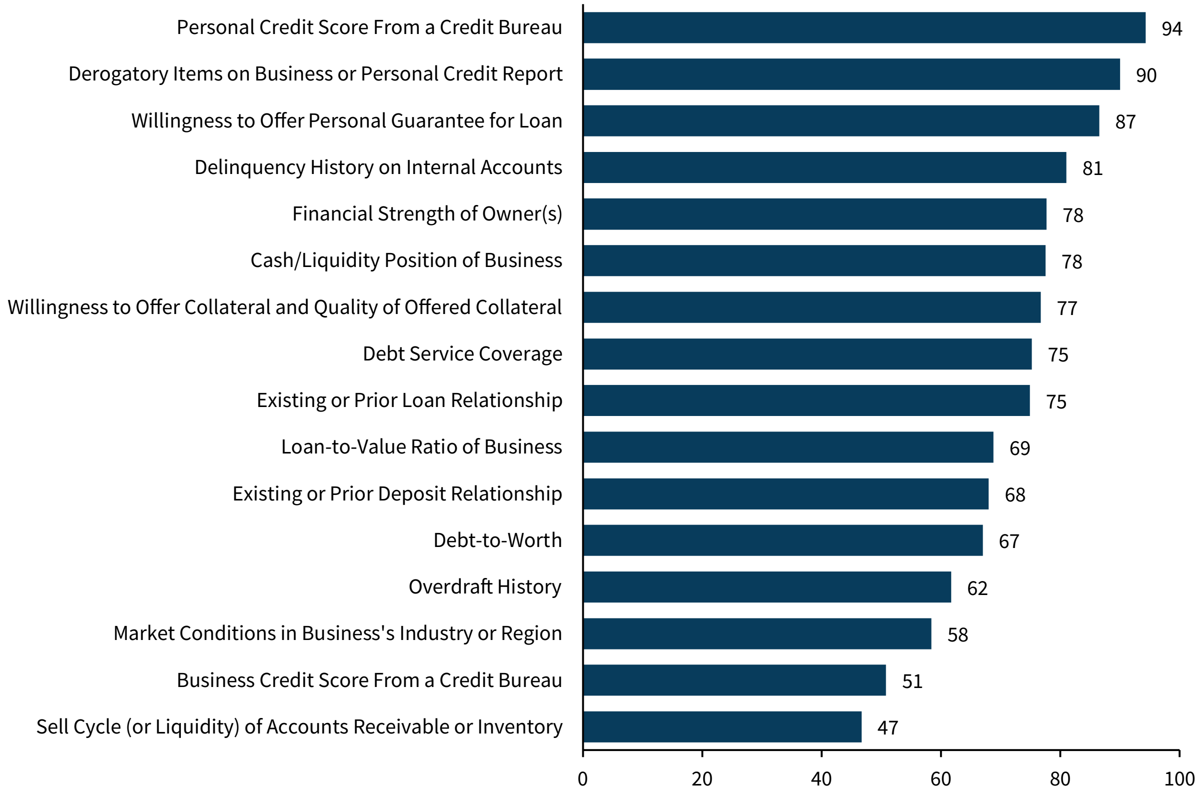
Percentage of Banks That Can Automatically Approve Small Business Loans for Various Loan Sizes, by Bank Size



Source: SBLS 2022 Question I.D3.
* Denotes a statistically significant difference between small and large banks at the 10 percent level.

Banks that use automated underwriting were also asked about the information they include in their credit-scoring models. The results are consistent with the previous finding in this section of heavy use of credit bureau information in small loan underwriting by large banks. Personal credit scores and derogatory items from a credit report, both forms of credit bureau information, are "sometimes," "almost always," or "always" used in credit-scoring models by 90 percent or more of banks that use automated underwriting (Figure 3.27). These banks also use internal bank information, such as the bank's experience with the borrower (both as a previous borrower and as a depositor). Large banks' reliance on automated underwriting models may restrict credit access for potential small business borrowers who lack credit histories or who have bad credit histories, but only if automated underwriting displaces rather than supplements traditional lending. In general, the information used in automated underwriting seems similar to the hard information used in non-automated underwriting (see Section 3.5).

FIGURE 3.27
Percentage of Automated Lending Banks That Use Specific Types of Information in Automated Underwriting



Source: SBLS 2022 Question I.D4.
Note: Results reflect a response of “sometimes uses” or “almost always or always uses” information of each kind in its credit-scoring model.

3.8 Conclusion

The results from the survey show the importance of loan size, bank size, and the intersection between loan and bank size in determining how loan information is gathered from the small business applicant and processed in the bank. Larger loans put more of a bank’s assets at risk and require more information before approval. At small banks, large loans typically undergo three or more levels of approval by a decision-maker, which may include the bank’s executive officers or, for especially large loans, the board of directors. For smaller loans, some large banks have diverged from traditional underwriting methods that focus on analyzing the applicant’s financial position and instead rely on hard information from credit bureaus. This sometimes leads to large banks’ use of automated or semi-automated underwriting for small loans, which can speed up approval times.

The survey also reveals substantial differences in whether banks conduct meetings directly between small business loan applicants and decision-makers. Such meetings are nearly ubiquitous among small banks but rare for large banks. Small banks also use more soft information, such as loan officer interviews and business plans, than large banks. These differences may contribute to advantages that small banks are believed to have in lending to marginal borrowers or those who lack hard information, including start-ups. In contrast, large banks may be better at serving businesses that lack collateral, as they are more likely to make small loans without requiring it.