TOTAL PROCESSING

Chargebacks Reality:

Why who you're processing with matters.

WWW.TOTALPROCESSING.COM

2020

About Total Processing

Founded in 2015, Total Processing is an all in one payment service provider with acquiring partnerships into 300 banks across the globe, offering state of the art processing solutions to merchants and businesses across the world.

Helping businesses worldwide, Total Processing's infrastructure of payment engineers and developers work in-house alongside a team of people-facing support staff to help pioneer a quality experience for all of their merchants.

Total Processing delivers on touchstones of quality, efficiency and speed in ensuring consistency within every client experience.

Offering their merchants a variety of payment methods that can be reconciled within their bespoke 'Total Control' CRM dashboard, Total Processing also provides Point of Sale machines alongside Virtual terminals, IVR and Recurring Payment services with ease of integration.

Total Processing is a provider of Payment Gateways and Merchant Accounts with the network to deliver on great rates and sustained partnerships.

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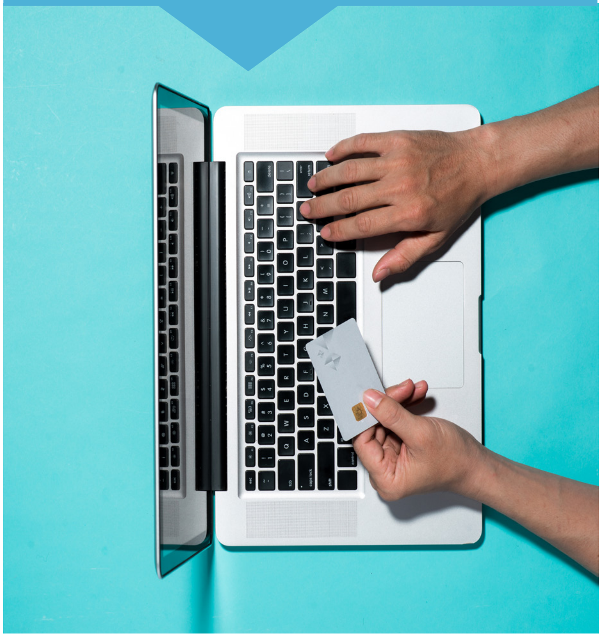
Chargebacks are being filed with such an alarming frequency that it has become commonplace for merchants to absorb the disruption as a cost of doing business.



Abstract

The onus on chargeback reconciliation often lies with the merchant, with the consumer being held accountable for nothing but filing the claim. In its simplest terms, the growing disparities in the rapid increase of chargeback claims, and the steadier growth of transactions - does point to a rise in friendly fraud.

However, this paper will fully overview the extent to which consumers utilise chargebacks in a growing age of e-commerce; and the instances in which the merchant may lay at fault.

We'll review the ways in which the use of fraud protection tools and third-party providers can minimise the variables within chargeback claims and disputes; and the credibility of the statistics behind chargeback representment (reversal).

In order to do this, we will detail the chargeback process and the way in which major card issuers and acquirers receive and dispute these claims between the merchant and consumer.

This paper will detail the perceived and true reasons behind a chargeback, the parties involved - especially where issuing banks and acquirers have often been ignored - and the usefulness of reason codes to these same parties.

We will outline the types of fraud and why chargeback ratios matter - depending on the industry the merchant operates in.

As a result, this will lead to a discussion on whether disputes are worth fighting and what types of payment you should accept.

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Introduction

Chargebacks are being filed with such an alarming frequency that it has become commonplace for merchants to absorb the disruption as a cost of doing business.

Chargebacks are a considerable drain on revenue and resources, with the long-term threat to business longevity becoming a point of examination in this paper.

However, the how and why behind receiving a chargeback can be better explained beyond customer dissatisfaction. In fact, when taking into account various factors such as issuing banks and authorised cardholders; chargebacks might just get more complicated - though more justifiable to the affected merchant.

Seeking to discover the disparities between chargeback ratios claims, this paper will discuss the frequency in which card-present and card-not-present transactions are disputed.

In doing so, this will play a part in the discussion of strong customer authentication (SCA) and fraud prevention methods in the e-commerce space.

Total Processing offers you complete merchant services with our all-in-one payment processing solutions and account management partnerships. Achieve ultimate freedom through the fraud mitigation tools we provide, and the competitive rates on upfront reserves we obtain to protect your business against the rising misuse of chargeback claims.

What is a Chargeback?

Chargebacks are the literal charging back of funds made in a transaction, due to fraudulent reasons.

With the UK making up 9 percent of online payment fraud's attack volume across the globe, merchants are failing to address the increasing threat of chargebacks as a legitimate fraud issue.

Chargeback Reasons:

There are 3 main reasons for a chargeback and 4 categories that issuing banks will mark a chargeback as.

The variety of reasons for filing chargebacks aren't as arbitrary as to fall into any distinct categories in reality.

The ratio of chargeback claims and rate disparities can have a significant impact on the merchant. Alternatively - as we will go on to discover - the value a chargeback rate holds itself, can be misconstrued in regards to merchants with high transaction volumes.

The main reasons for chargebacks are as follows:

1: Friendly Fraud

Friendly fraud accounts for the majority of card-present and card-not-present fraud. Accounting for 60-80 percent of chargeback claims, the rate of chargebacks have increased at 3 times the rate of transaction growth. With a 41 percent growth rate annually across the globe; friendly fraud has seen a 13 percent growth rate over the last 24 months within the UK.

Whilst the main reasons for friendly fraud can be argued with the instant gratification a customer receives in place of the comparable and drawn out refund process, chargebacks by these means can be classified as cyber shoplifting.

However, in more genuine instances, the customer is likely to have experienced buyer's remorse or alternatively; the purchase was made by an authorised member of the family but not by the cardholder themselves.

In many cases, the customer is not at fault for filing the chargeback at all.

It has been revealed that a chargeback cited as friendly fraud, can often be sourced to the bank misinterpreting the customer's request for information.

2. Merchant Error

Considered the second leading cause of chargebacks, merchant error accounts for 20-40 percent of the reasons why a chargeback is filed.

Though there is a varied spectrum of causes for merchant error, the most innocuous begin with minor oversights and end with overzealous merchant activity.

Minor oversights can include:

- The omission of an action
- The omission of applicable fees
- Incorrect data entry
- The merchant falsely declines a payment - affecting 15 percent of cardholders (otherwise known as a false positive loss in revenue).

Overzealous activity can lead to bigger oversights:

- Failure to obtain customer authentication
- Failure to credit customers in a timely manner
- Merchant ignores cancellation fees
- Merchant processes single transactions multiple times
- Merchant charges the customer before the product is shipped

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3. Criminal Activity

The 3rd and least likely source for chargeback claims is criminal fraud, which accounts for only 1-10 percent of claims.

As of 2014, the average merchant suffered 133 successfully fraudulent transactions a month over the 195.6 billion transactions made by credit cards worldwide.

Fraud accounts for £310 million annually in the UK by current figures and costs an estimated £2.24 for every £1 in revenue for each affected merchant. Customers arguably use the malicious perception of fraud to their advantage, resulting in this hierarchy of figures where criminal activity actually places last on the tier.

Category Codes:

Reasons for chargebacks can be emotionally circumstantial, but an issuing bank is going to categorise it regardless, to help identify the dispute.

Whilst this process varies depending on the issuer, reason codes will fall within 4 categories:

Technical:

Chargebacks that are categorised with a technical reason code are typically filed due to expired authentication online, insufficient funds in the customer's account or, processor error.

Clerical:

Chargebacks that are filed as clerical chargebacks, refer to claims made in circumstances of duplicate or incorrect billings - or over refunds never issued.

Quality:

Chargebacks filed with quality reason codes commonly refer to goods never received by the customer.

Fraud:

Chargebacks categorised with a fraud code are unauthorised purchased goods, with some cases of identity theft.

Ultimately, these short alphanumeric codes can help merchants address chargeback triggers within their business - to a point. Other management tools such as BIN hotlists that allow merchants to geographically manage their transactions, will help the merchant streamline and profile their consumers.

The Real Disparities:

Although chargebacks can be seen as having a negative impact on merchants worldwide, we cannot truly assess their impact due to the unfair rate at which businesses are able to, and choose to, dispute them - and the rates at which acquirers will accept a chargeback claim.

Dispute ratios will occur throughout different acquirers and industries and quite simply, the type of chargeback reason code merchants receive will ultimately affect their revenue loss.

To explain, both the reason code and the origin of the chargeback - whether they be card-present or card-not-present, will have some serious significance.

In today's society, it is typically card-not-present transactions that are given any sort of prevalence in fraud discussions, as they account for up to 70 percent of all card fraud in the first world.

80 percent of merchants that refrain from selling goods online or digital services, will see noticeably lower chargeback rates of less than 0.5 percent.

However, this too is dependent on the issuer and acquirer of the customer and the merchant.

A study conducted by Chargebacks911 and Kount, revealed that depending on the industry, merchants would receive higher chargeback values from card-present claims, but en masse, disputes in both card-present and card-not-present transactions still had lower values than those from Discover and American Express. Visa and Mastercard had a stronger likelihood of initiating card-not-present chargebacks at 87 percent vs 78 percent of card-present transactions.

To reiterate, this doesn't lessen the severity of the chargeback. Depending on the code assigned, a merchant's chargeback ratio can be affected and ultimately, can lead to serious processing reparations for the merchant.

Alternatively, given American Express and Discover's e-commerce preference, they had a prevalence of disputing higher chargeback values from card-not-present transactions on behalf of their cardholders.

Card-not-present chargebacks from American Express and Discover were 12 percent more valuable than their card-present chargebacks and accrued 10 percent more revenue loss for merchants than card-present disputed transactions.

Prior to SCA, studies showed that less than 80 percent of card-not-present payments are authorized vs 96 percent of card-present payments. This is known as the acceptance gap. This gap calls for more recognition and consideration by acquirers of the fraud tools that have been put in place by merchants; especially given the mandatory authentication that is called for by SCA with its multiple-factor and possession authentication elements at the digital checkout.

Can Merchants handle it?

Given the complicated parameters surrounding chargeback disputes in comparison to the ease with which a customer can file one, it is no surprise that only 82 percent of businesses and organisations dispute them.

The data gets even more clouded as nearly ¼ of merchants fail to track their dispute wins and the majority are unsuccessful. Equally, 28 percent of merchants do not believe they accrue enough chargebacks to justify representment.

There are variables to be considered. Merchants with businesses that have a higher transaction volume intake typically see a higher chargeback rate (19 percent) over 1 percent, where 0.1 percent is optimal - but can absorb the cost of this without a detrimental revenue loss.

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Chargeback Ratios:

How are Chargeback rates calculated?

Every merchant's processing rates and fees (and the resultant ability to process) are decided by acquirers on their transaction volumes and their chargeback rates. In determining their chargeback rates - or ratios - for better clarification of the process, an assessment is made of the merchant's business operations within certain time parameters. This varies, depending on the acquirer, the type of disputes, and on the card network.

The first way to determine a chargeback ratio is based on transaction count. In this case, a transaction count is determined by dividing the total number of new chargebacks, by the total number of sales within the decided time parameters.

The other way of assessing a chargeback ratio is by transaction volume. Via this method, an acquirer would divide the monetary amount of new chargebacks by the monetary amount of sales.

Mastercard and Visa have different ways of calculating a chargeback rate.

Where Mastercard will divide a merchant's chargebacks for their current month of processing by their previous month's transactions to calculate this ratio; Visa will apply this same equation to a single month.

Through Visa's 8-month dispute monitoring program, Visa will fine a merchant $50 USD for every dispute filed against them within the first 3 months of this period. Merchants with an excessive chargeback problem will be subject to $100 fines and a 12-month monitoring program.

Mastercard's similar EFM (Excessive Fraud Merchant) and ECM (Excessive Chargeback Merchant) programs are in place to reduce e-commerce fraud and lower chargeback thresholds. Within any given month a merchant can find themselves subject to fines of $500 USD to $200,000 USD - depending on the severity of the fraud or number of chargebacks.

Both schemes consider the number of transactions processed through 3D secure when determining the severity of a fine.

The Chargeback Process:

The chargeback process is initiated by the customer's credit card provider.

When a customer - for whatever reason - issues a chargeback through their credit card provider, it places action on the merchant (which is not easily refuted) to fulfil all of, or part of, the transaction on behalf of the cardholder.

When filing a chargeback the customer might be asked to provide the issuer with the name of the company they paid money to, alongside the date and method of payment.

The issuer and acquirer may require additional information on the goods and the reason for the chargeback, as well as proof of return where relevant.

In some cases, a customer may be asked to provide invoices, receipts and any correspondence they might have had with the merchant.

The customer's issuing bank sends the transaction back to the acquirer, who then makes the demand to the merchant.

Within the 4-6 month window that customers have to initiate a chargeback, the acquirer is obliged to transfer funds from the merchant's accounts upon receipt of a claim. Only upon a successful dispute can a merchant get them back in what is called a second chargeback.

A second chargeback or pre-arbitration follows representment - or the merchant's claim to dispute the initial chargeback - and the cardholder's account is debited.

The cardholder receives this dispute and depending on the outcome, will be rebilled or credited for the initial transaction. If a decision can not be reached, the decision is left in the hands of the card scheme.

If a merchant fails to keep a successful chargeback ratio of 1 percent or lower (depending on their acquirer) they are subject to fines or a ban from processing.

It is a foregone necessity in the age of e-commerce that merchants must utilise tools to screen for fraud risks to mitigate and monitor the potential for chargeback claims.

Whilst chargebacks are a threat to businesses across the globe, it is inherent to stress that they are not a legal right.

A Matter Of Perspective:

Consumer vs Merchant

Whilst there is an opportunity to centre the blame for revenue loss on the customer, a lot of onus can be placed within the bias of the card issuers and whether the merchants are utilising fraud tools.

Another considerable element in the case of chargeback ratios comes down to expanding the assessment of the consumer.

A study of businesses operating across the US, Western Europe and Asia reported that 46 percent of chargebacks were raised from the United States compared to only 16 percent that originated in Asia.

This data lends itself to the shopping behaviour of American customers compared to Asian consumers and would lend itself to a comparison of the payment methods and platforms available in both continents.

With these complications, the easiest thing for acquirers to do is to place the responsibility on the merchant to file a second chargeback in cases of a dispute.

Based on Chargeback911's and Kount's diverse study of 1000 representatives of online and omnichannel e-commerce merchants, 80 percent reported that they were currently disputing chargebacks as part of their daily business operations.

Over 40 percent of those profiled, had high optimum chargeback rates of less than 0.1 percent but less than half of this group were able to attain this rate.

It was more common for the rates to be 1 percent or over (30 percent). However, high grossing industries with revenues exceeding 10 million USD did not hold chargeback rates with these values as an optimum; 19 percent of which held rates over 1 percent.

Industries that grossed 10 million and over, comfortably managed higher chargeback rates than smaller merchants.

In fact, only ⅓ of merchants offering digital goods target chargeback ratios below 1 percent due to the bias of card-not-present claims and the rising ease of e-commerce fraud.

This is likely due to the preventative implementation of a higher fixed bond over a rolling reserve and other tools, with 45 percent of businesses utilizing the services of a third-party fraud solutions provider.

For high-risk businesses, wherein the merchant has a large transaction volume or trades within a high-risk industry, the upfront payment of a fixed bond or a large percentage of their monthly revenue will be used in the case of chargebacks to protect them.

35 percent of merchants with revenue below 10 million USD from e-commerce transactions per annum are using a third-party fraud solution service. This is in comparison to 56 percent of merchants whose revenue is above 10 million USD per annum.

The majority of merchants used address verification (AVS) and credit card verification (CVV) tools as a way of preventing chargebacks within their business (62 percent); where only 42 percent implemented email verification and sought chargeback representment.

Only a minority carried out hotlists and velocity checks - where they profiled the spending behaviour of a customer to verify whether the activity was fraudulent.

A study conducted between 2017 and 2018 showed that merchants who implemented chargeback prevention strategies saw a 13.3% decrease in their chargeback-to-transaction ratio.

Other methods such as prevention alerts, allowed 60% of merchants to resolve a minimum of 30% of disputes before they could escalate into a chargeback claim that threatened both revenue and processing viability.

Whilst 77 percent of businesses implement three or more fraud prevention tools within their daily operations, only 23 percent use more than 10, and studies illustrate that these are those with higher online revenues.

With a clear disparity between lower and higher online revenue merchants, the statistics evidence why the ratios on chargebacks are what they are:

- 27 percent of organisations not fighting chargebacks claims aren't doing so, due to a lack of resources.
- 15 percent of merchants felt their chances of successfully disputing a chargeback claim were low and were discouraged from doing so.
- 10 percent of those in the study had no clear reason as to why they weren't fighting chargeback claims.

£25bn lost to Chargebacks in

2020

The Future of Fraud:

With the increasing use of e-commerce due to its expanding ease of use and omnichannel platforms; the avenues for fraud are increasing with it. With additional checkout flows, accepted payment methods and money flow being introduced to the online marketplace - the opportunity for fraud is rife.

Whilst there is additional security in mobile payments and NFC payments, with the implementation of SCA viewed as an increase to this, we are still a long way off from a smooth implementation - with gaps in the industry and the rapid pace of e-commerce of other technologies threatening to open up more avenues for chargebacks.

Chargebacks can be a hard one for merchants to mitigate alone. By the end of 2020, e-commerce is expected to lose over £25bn (originally USD) to chargebacks.

Whilst current figures show that many merchants don't consider chargebacks a worthy fight, they will eventually become an inevitable one.

However, as it stands, we have illustrated that the fight isn't necessarily fair. Not to say that the blame solely lays with the merchant, consumer, issuer or acquirer; it is definitely clear that whilst filing a chargeback is easy, the context of chargebacks is wholly complex.

As this paper has demonstrated - despite a higher chargeback ratio - higher revenues can be maintained in the e-commerce space with third-party fraud management.

Total Processing utilizes an advanced and propriety fraud protection suite within their payment gateway, to ensure that your business is protected against chargebacks.

Working with a payments service provider allows merchants to achieve optimum and total control over transactions. With their assistance businesses will have real time knowledge and management over changing chargeback parameters alongside diligent practices that allow merchants to reduce their ratios with our prevention alerts and premium hotlists, that allow you to precheck and ban suspicious activity based on location, device, IP and email.

We also offer an add-value service that leverages transactional data with consortium data and machine learning to ensure that merchants are doing all they can to prevent chargebacks and criminal fraud within their business.

Our merchant services ensure that you're getting the best rates and the most competitive reserves to protect your business. With our network of acquiring relationships; we're open-to-all with your business at the forefront of our interests.

This information is valid as of April 28th 2020

Discover real-time updates via:
www.totalprocessing.com

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