VIEW POINT

CHARGING UP FOR CHARGEBACKS

Abstract

Credit card disputes are outpacing the growth of global ecommerce transactions. This presents significant challenges for card issuers and merchants, because of the high costs of resolving chargebacks. This paper examines the issues involved and presents the benefits of deploying cutting-edge technologies to reinvent legacy chargeback processes.

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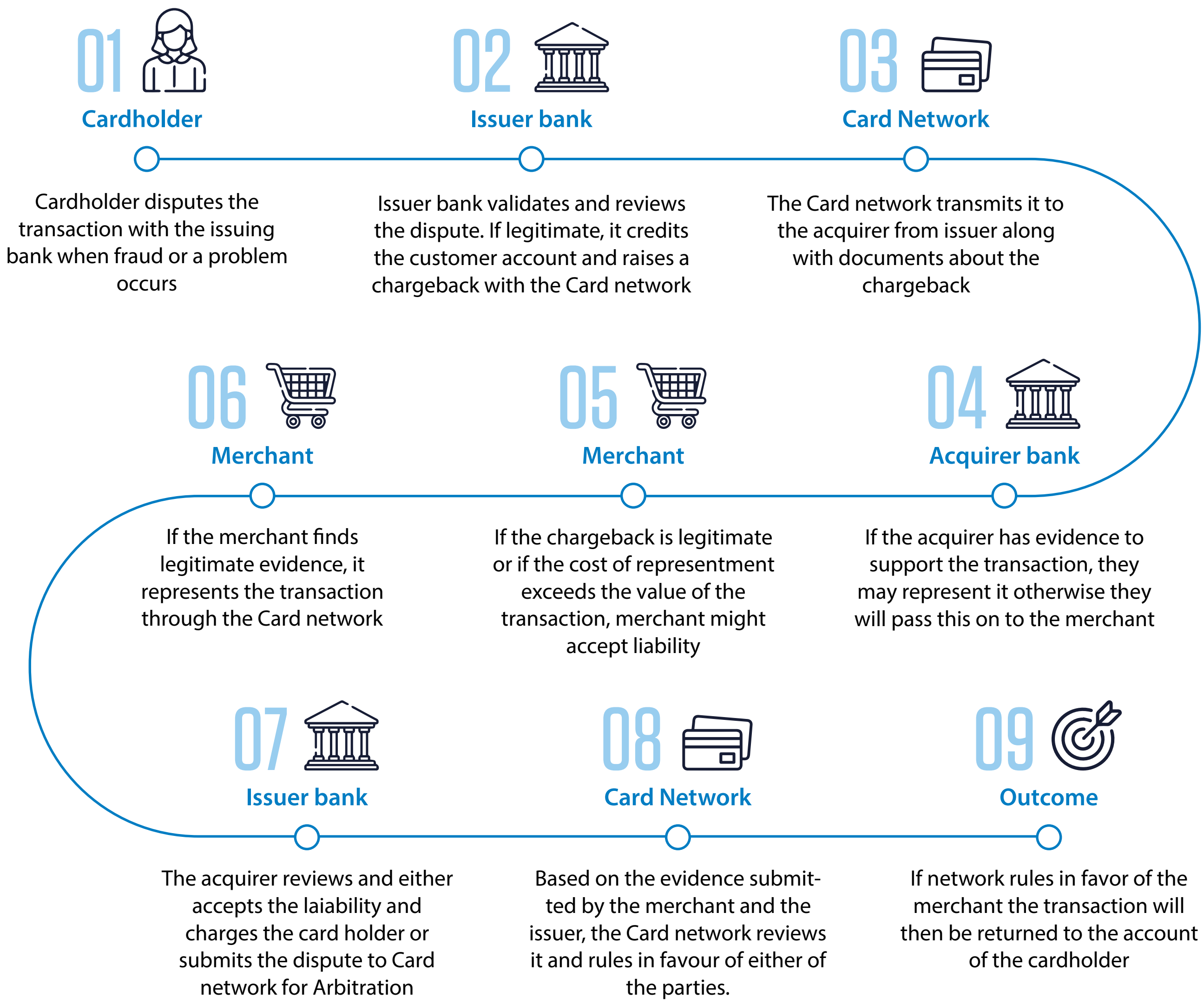
Chargebacks, a growing problem

A chargeback is the amount returned by a credit card issuer to a cardholder who successfully disputes a purchase transaction. The growth of these disputes — many of them fraudulent — is fast overshadowing the growing number of online transactions. Per a Nilson report, worldwide card fraud losses incurred by issuers, merchants, and acquirers are set to cross a staggering $43 billion[1] by the end of 2025. Undoubtedly, card issuing banks will benefit from the growth in purchase volumes. However, they are also likely to face increased heat from disputes and chargebacks.

The mechanisms of chargebacks

Today, many consumers admit having raised a dispute out of convenience – what is commonly known as 'friendly fraud'. This situation arises when a card holder's family or friends use the cardholder's details to purchase goods and services without informing the cardholder. Another type called criminal fraud is committed when customers raise disputes to derive benefits without having any legitimate issue.

The figure below illustrates the existing disputes and chargeback value-chain.



Card issuers are challenged because of the ways in which a dispute is currently being handled. The timeframe to resolve a dispute is getting longer, sometimes taking as much as 45-60 days, and customers often do not have visibility into the entire dispute handling and chargeback processing value chain. This situation is further accentuated by frequent changes in the Payments Network Association rules.

In addition, there are some startling statistics from both an issuer and merchant perspective. Over 60% of customers contact their bank instead of their merchant in case of a dispute, and nearly 71% of the chargebacks loss for transactions is presumably a case of "friendly fraud." Even more startling, 40% of consumers who file a fraudulent chargeback will file it again in the next 60 days and 50% within 90 days[2].

[1] https://nilsonreport.com/upload/pdf/Global_Card_Fraud_to_Reach_43.8B_Visa_.pdf

[2] https://www.invespcro.com/blog/e-commerce-fraud-and-chargebacks-infographic/

The high costs of chargebacks

The growing cost of chargebacks has been a problem for years with the current data suggesting that it may cross $117 billion by 2023. Globally, nearly two-thirds of the total chargeback costs are borne by merchants and one-third by issuers. Also, managing the chargeback process sometimes costs more than the chargeback claim – for every $1 disputed, merchants bear $1.5 more in costs[3 4].

For banks too, chargebacks are increasingly becoming a serious concern and impacting profitability due to their various associated costs. These include:

- **Quality control costs:** Chargebacks are complex and involve human agents assigning reason codes to disputes. There are around 23 reason codes in Visa and 19 reason codes in MasterCard across different categories like fraud, authorization, processing errors, and consumer disputes. This often causes errors to creep in through human agents incorrectly assigning wrong reason codes based on personal interpretations. The potential penalties from card network associations like Visa or Mastercard warrants banks to increase their quality control teams leading to increased quality control costs.
- **Costs of maintaining legacy systems:** Many banks use legacy systems to manage their chargebacks. This complex infrastructure comes with huge maintenance costs, dampens the agility of banks, and creates delays in closure.
- **Costs of refunds:** There are scenarios wherein an issuing bank may choose not to investigate a transaction, especially if the cost of investigation is likely to be more than the amount disputed. Thus, these direct refunds credited to customers without any investigation is another additional cost for the card issuers which has an impact on the bottom-line.
- **Cost of arbitration:** Irrespective of the card network, whether Visa or MasterCard, if a chargeback goes into arbitration, it can cost the losing party upwards of 600$ towards the costs of arbitration. If the issuing bank loses the arbitration against the acquiring bank, they are liable for this cost as well.

Thus, it can be safely concluded that it is in the best interests of card issuers and merchants to revamp their dispute resolution process through digital interventions.

[3] https://chargebacks911.com/chargeback-stats/

[4] https://www.verifi.com/wp-content/uploads/2018/04/The-Chargeback-Triangle_Verifi-Javelin.pdf

A triad of challenges

Tackling the issues related to chargebacks requires understanding the challenges in three areas — those faced by agents, card issuers, and merchants.

- **Challenges faced by agents:** The agents handling the disputes and chargeback process have a mammoth task on hand. They need to manually sift through the complex process of identifying the correct reason code as per the requirement, which is often time-consuming and error prone. In addition, the agents typically lack adequate training which leads to higher case turnaround time and more false positives.
- **Challenges faced by card issuers:** Card issuers need to spend a huge amount of money in training the agents from time-to-time. There are also challenges with their legacy dispute and chargeback systems which translates into high maintenance costs and increased time taken to resolve a dispute. They also lack digital solutions focused on automation and analytics to make the process more streamlined.
- **Challenges faced by merchants:** As per a survey conducted by Kount, it is seen that for most merchants, the major challenge is around representment — i.e., improving their win rates and handling the chargeback operations — as it is not their core business. Merchants struggle with identifying winnable chargebacks and they dispute only about 43% of the chargebacks[5 6].

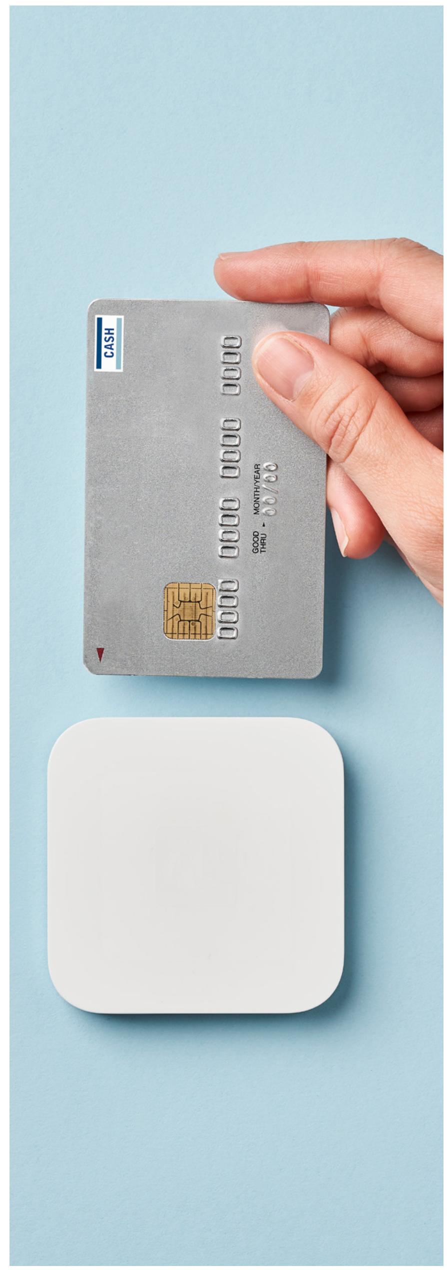
[5] https://kount.com/blog/top-chargeback-challenges/

[6] https://www.accertify.com/wp-content/uploads/2019/12/accertify_chargeback_infographic_rvsd.pdf

Technology-led reinvention

Today, vendors such as FIS, Midigator, Bolt, and Verifi provide several mature technology solutions to deal cost-effectively with various chargebacks-related challenges. Their platforms featuring comprehensive automated chargeback management solutions, predictive analytics, workflows, and rule-based structures, offer banks several benefits. These include:

- **Reduced manual effort and operational costs:** Predictive analytics with tools such as R and SAS can identify the traits, signals, and patterns of customers who are most likely to request a chargeback. This will help banks segregate their card customers into low- and high-risk buckets, based on the assessed probability of their raising a chargeback claim. Agents will thus be enabled to make proactive calls to suspect customers when they lodge a chargeback claim and take appropriate actions. This will reduce the average handling time for chargeback cases, increase productivity, and reduce operational costs as well.
- **Reduced errors and case handling times:** Agents currently need to go through voluminous documents from MasterCard and Visa and rely on their judgement to identify the correct reason code for a dispute. However, analytical tools such as R & SAS can be deployed to help agents accurately assess the right reason codes for each chargeback case. This will help agents close their cases faster and with fewer errors, thereby reducing the average case handling time.
- **Enhanced friendly fraud assessment:** Data analytics models can help delineate the patterns and characteristics of friendly fraud and identify customers indulging repeatedly in such behavior. This will help issuing banks better manage their revenue portfolios.
- **Increased straight-through processing:** Robotics process automation (RPA) & intelligent optical character recognition (IOCR) can help card issuers to automate and simplify their processes to raise and review disputes. This can lead to around 15-20% effort reduction though automated prechecks to validate a dispute and automated communication to customer requesting for more info in case of missing information. After these validations, the system can automatically calculate the refund amount and provide provisional credit to the customer, help with letter creation for a temporary credit issue, or apply for chargeback to a card association site.
- **Improved customer communications:** Customers need to be adequately informed at each stage of the disputes and chargeback process by both card issuers and merchants, as per Regulation Z. Using RPA for automated letter generation can help simplify the manual task of customer communication. Banks can also use RPA for customer outreach programs for the timely cancellation of subscription cases, to inform potential offenders on out-of-date chargeback policies, or to provide the documentation required to win a dispute. Merchants can also use automation technology to reach out to repeat offenders, and to communicate on double-billing or clerical errors, undelivered products, or cancelled orders due to products not matching their website descriptions.
- **Better fraud prevention:** Artificial intelligence-driven digital fraud prevention solutions such as from Kount or Accertify can help prevent criminal fraud before the transaction is accepted by the merchant. These single dashboard solutions also provide merchants with the tools, alerts, and notifications needed to identify and reduce friendly fraud. With these solutions, merchants can deflect unnecessary chargebacks that are about to be issued by stopping shipments or by refunding purchases, and thus prevent inventory loss and recover revenue loss.



The way ahead

Over the shorter term, card issuers and merchants could use some easily implementable practices to reduce their percentages of disputes and chargebacks, and to improve customer experience. Merchants should adopt a robust product return policy and communicate the same through their mobile applications and websites. Further, since many disputes are raised by customers regarding auto-deduction through subscriptions, merchants should enable opt-in rather than opt-out subscription models.

Also, when it comes to friendly fraud, customers are currently raising disputes out of convenience. To reduce the prevalence of this practice, banks should penalize such customers with a specific amount for raising a false claim dispute whenever a merchant is successfully able to defend the charge, along with reversing any negative fees for merchants.

To lower their chargebacks management costs to a greater degree and over the longer term will require more serious measures. Traditionally, offshoring processes related to chargebacks provided immediate cost-savings through labor arbitrage. However, today, digital transformation has become imperative and is no longer a matter of choice. Banks should look to replace their legacy chargeback management platforms using the help of service providers to implement the next-generation platforms discussed earlier. It is only technology that can charge-up legacy processes to deal with the growing challenges of the future.

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