THE CHARGEBACK PROCESS IS BROKEN: **HERE IS HOW IT CAN BE FIXED**

WHITE PAPER

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According to one widely cited study by the Aite Group, chargebacks will grow from $23 billion in 2018 to $35 billion in 2021.[1] Complicating the surge is that as many as 80% of chargeback cases are "friendly fraud" – unjustified requests knowingly and intentionally submitted by cardholders to cheat the system. These claims are quite problematic; they cause significant delays to the processing of legitimate claims.

$23 billion

Chargebacks in 2018

$35 billion

Chargebacks in 2021

Worse yet, this may only be the beginning. One major survey, commissioned in September 2020, found that friendly fraud jumped a whopping 54% over the previous 12 months. More than one third (36%) of British consumers openly admitted to committing friendly fraud regarding items they ordered from retailers, while 36.1% of them demanded refunds for unauthorized purchases that, in fact, they knowingly authorized. The comparable statistics in the United States were similar.[2]

So, chargeback requests will grow by leaps and bounds in the years ahead. But are banks equipped to handle the traffic?

1 "The Global Chargeback Landscape: Rapidly Evolving," https://www.aitegroup.com/report/global-chargeback-landscape-rapidly-evolving

2 Scammers Love Bitcoin, But Consumers Aren't So Enthusiastic," https://www.pymnts.com/blockchain/bitcoin/2020/scammers-love-bitcoin-but-consumers-arent-so-enthusiastic/

Chargebacks: A brief history

A chargeback is a retroactive cancellation of a payment made by credit card or debit card.

The chargeback process remains much the same as it was when it was originally designed more than 40 years ago. The cardholder submits a request to the issuing bank, selects an appropriate "reason code" justifying the chargeback and submits supporting documents. The issuing bank reviews the file and decides – theoretically based on the chargeback guidelines formulated by the relevant credit card network – whether or not a dispute should be raised. If one is, then the acquiring bank is notified, and the merchant has a fixed period with which to respond. If a response, known as a "representment," is not forthcoming, the cardholder wins by default. If the merchant provides a representment, then the cardholder can respond. The issuing and acquiring banks then decide how to rule. If a decision is not reached, either side may pursue arbitration.

Chargeback guidelines, however, are so massive they approach a thousand pages in length. They are complicated and require both patience and persistence to finish. And then, even if you do manage to read them cover to cover, you still have to pause along the way, paragraph by paragraph, to decipher them.

Perhaps more troubling is the fact that the guidelines are this way by design. For decades, major card issuers have had limited programs for training on claims management to registered service providers. Registered issuers are not required to participate in training and in fact often reject it and opt-out. Issuers have little motivation to assist consumers or consumer advocates with understanding the rules of claims management despite the barrier it represents to better service.

Another complication is that chargeback guidelines are amended and supplanted with new material as often as twice a year. For chargeback professionals, the accurate processing of a transaction dispute requires not only a fluency with massive documents but also necessitates the ability to assimilate changes. That's a tall order.

The failure of professional programming

Over the past four decades the chargeback process has become more complex due to two principal factors. First, new reason codes have been introduced, old ones have been redefined, and deadlines have been changed. For bank employees, keeping up with the pace is tougher than ever.

Second, new types of fraud have emerged, and as important, the vehicles with which consumers may be victimized by fraud have increased at an alarming rate. Fraudsters are more active and leveraging creative ways to avoid chargebacks. Today, for example, many more of them are requesting payment in cryptocurrency, which, unlike credit and debit card payments, provide them with relative anonymity.[3]

In spite of all this, the tools issuing banks have at their disposal to uncover fraud patterns have not matured in tandem. So, banks are left trying to apply what have become antiquated chargeback rules to this new reality. The result is massive inefficiency, if not failure.

3 "Scammers Love Bitcoin, But Consumers Aren't So Enthusiastic," https://www.pymnts.com/blockchain/bitcoin/2020/scammers-love-bitcoin-but-consumers-arent-so-enthusiastic/

The credit card networks understand the challenge. For this reason, they organize training programs for claims management service providers. The resources the card networks invest in producing their chargeback guidelines – especially in terms of manpower and time – are considerable, as are the resources that banks are required to commit to process chargebacks. So much so that it is fair to assume that these training sessions would be well attended. After all, the information imparted and exchanged during these encounters is vital for chargeback professionals.

Nonetheless, attendance is optional. Neither the card networks nor most card-issuing banks require it. Based on MyChargeBack's research, only one out of 28 issuing banks in all of Scandinavia requires training.

A key reason why these training programs are ignored is that the card networks seldom carry out spot checks to evaluate the quality of their chargeback service issuers. Nor do they ever have to pass any examination. The card networks simply have no idea what their level of competence is.

The inevitable result is that year by year, amendment by amendment, the chargeback professionals entrusted with processing complex transaction disputes become less familiar with the rules and the nuances between them. As a result, decisions regarding issues that ought to be objective – such as whether a dispute meets the criteria for a chargeback – become increasingly subjective. Rules and regulations exist to ensure maximum objectivity. That being the case, the gravitation to subjectivity is a prescription for chaos.

The card-not-present watershed

Meanwhile, the rapid growth of internet commerce, supercharged by COVID closures and lockdowns, has yielded a dramatic rise in the number of card-not-present (CNP) transactions. In April 2020, Mastercard noted that CNP transactions reached 50% of its volume.[4] Over the next twelve months, it registered one billion *more* card-not-present transactions than the year before.[5] The Visa Back to Business Study, released in January 2021, found that 74% of consumers expected to continue to opt for making contactless purchases even after vaccinations become widespread. Only 16% thought they would revert to their previous payment routine.[6]

This is a watershed moment. It also explains the related dramatic rise in chargeback requests, since online purchasers cannot physically inspect their purchases like they used to in brick-and-mortar stores. As a result, consumers are bound to make mistakes in ordering, and merchants can make mistakes of their own in shipping.

Banks have responded to the rise in chargeback requests in one of three ways:

1. **Hiring temporary workers to supplement their understaffed dispute departments.** These employees have little experience with chargebacks. When pressed, they tend to reject them simply because it is the easiest course of action. And who can blame them? They are generally assigned to the bank's operations team, which places a premium on speed and efficiency. And since their status at the bank is temporary, they have no vested interest or incentive to consider the long-term effects of their actions on larger issues such as customer satisfaction and retention. Few banks will consider investing in temporary employees by enrolling them in training sessions organized by the card networks.
2. **Contracting out chargeback responsibilities to outside firms.** These firms project themselves as experts in their fields and, therefore, see no reason to assume that attendance at card network training sessions would have any value.
3. **Allowing themselves to get bogged down:** A cardholder does not receive timely service and, as a result, the deadline for submitting a chargeback often expires.

The clear significance of the card-not-present watershed is that the avalanche of chargebacks it unleashed is not going to subside anytime soon, if ever.

4 "Chronicles of the New Normal," https://www.mastercardservices.com/en/recovery-insights/chronicles-new-normal-managing-disputes

5 "Mastercard sees contactless acceptance triple in U.S., Brazil," https://www.paymentssource.com/news/mastercard-sees-contactless-acceptance-triple-in-u-s-brazil

6 "The Visa Back to Business Study," https://usa.visa.com/content/dam/VCOM/blogs/visa-back-to-business-study-jan21.pdf

The absence of consumer programming

Card networks are also uninterested in educating cardholders about their chargeback rights.

They do not offer parallel in-person or online training for consumers. So, while employees of bank dispute departments are gradually losing whatever expertise they may once have had, cardholders who rely on them to handle their cases fairly have the disadvantage of being unable to cite appropriate chargeback guidelines when communicating with their bank interlocutors. **As a result, mistakes are made in chargeback processing that are avoidable, without the affected cardholders even realizing it.**

What can the credit card networks do?

In a post-pandemic world that has gone virtual, card networks could easily address the problem by requiring issuing banks and their third-party dispute processors to enroll their chargeback professionals in annual online refresher courses.

To ensure that those who register pay attention, tests could be administered at the end of the course, and only those who pass would be entitled to process chargebacks.

Banks that refuse to cooperate could face fines or temporary suspension from issuing cards. Yes, there will be banks that will object, but a reform such as this would go a long way to rectify the problem. In fact, credit card networks can already impose harsher sanctions on issuing banks for various breaches of their agreements. Compliance, of course, is basic to banking. Standardized procedures have been implemented for banks regarding Know Your Customer (KYC) and Anti-Money Laundering (AML) regulations throughout the European Union (EU), to provide just one example.[7]

In addition, testing bank dispute department staff complements existing obligations imposed on banks by financial regulators. Banks in the United Kingdom, for example, are required by the Financial Conduct Authority (FCA), to "make sure appropriate training is provided so employees remain competent" and "monitor and regularly assess the training's effectiveness to make sure it meets objectives."[8]

7 "European Banking Authority - Factsheet on AML/CFT," https://www.eba.europa.eu/sites/default/documents/files/document_library/News%20and%20Press/Press%20Room/Press%20Releases/2020/EBA%20acts%20to%20improve%20AML/CFT%20supervision%20in%20Europe/AML%20CFT%20Factsheet.pdf

8 "Training and competence," https://www.fca.org.uk/firms/training-competence

Reducing the burden on banks

For issuing banks the sheer number of chargebacks means they are often seen as a burden, if not a necessary evil that they are obliged to undertake to be able to offer credit cards to their customers. It's a losing proposition, and a costly one, since the salaries they pay to staff tasked with processing credit card disputes are not reimbursed by the card networks.

When it comes to the allocation of resources, it should surprise no one that dispute departments are not a priority. After all, they burn money rather than generate it. Bank executives would naturally prefer to invest in profitable departments such as those that deal with loans, mortgages and business services.

So how can banks hope to cope with chargebacks without sacrificing the levels of service and objectivity that cardholders have a right to expect?

In today's banking environment, the current alternatives are neither sustainable nor acceptable. Turning to untrained temporary employees does not yield the level of service that banks ought to provide their customers. Contracting out the entire chargeback system to outside firms places the decision making in the hands of anonymous individuals who are responsible neither to the bank nor to the cardholder. And allowing themselves to get so bogged down that the cardholder is denied professional service ought to be a non-starter.

Ideally, established third-party chargeback service providers can enter the system as temporary processors when the demand requires it. Working with the bank's dispute department, third-party chargeback service providers can be mobilized at a moment's notice and handle the cases until the demand subsides. Given their experience, moreover, they would not need to undergo onboarding like temporary employees. In fact, they could be called upon to provide training to the bank's dispute staff when necessary. And, unlike an outside firm contracted to permanently deal with the bank's case load *in absentia*, a chargeback service provider would be responsible to the bank, rather than function independently of it.

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Cardholder Solutions

Without consulting with an independent chargeback professional, cardholders can be misled and be deprived of the opportunity to recover their money.

Until the system is fixed, cardholders can contend with its defects by consulting with independent chargeback professionals before they approach their banks. This is especially prudent advice for cardholders with complex, card-not-present disputes involving services that were not provided as contracted, because these transactions are particularly difficult to substantiate to a bank's satisfaction. Since services, unlike goods, are not physical, their delivery can only be established through documentation. And merchants can use deception to manipulate documents they have to claim you received a service that you really did not. That is yet another systemic disadvantage for the consumer.

Due to the paucity of training, we have encountered banks all over the world that are apt to advise customers that chargebacks are unavailable for authorized transactions. Or that chargebacks are unavailable for services. In both cases, this is inaccurate. Without consulting with an independent chargeback professional, cardholders can be misled and be deprived of the opportunity to recover their money. If nothing else proves that the chargeback process is broken, that most certainly does.