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Sizing Up the Impact of CNP Fraud Disputes

Leveling the playing field to prevent illegitimate disputes

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One of the most common types of fraud, first-party misuse, could account for between 40 to 80 percent of all fraud losses.[1] Visa's updated compelling evidence requirements for card-not-present fraud disputes, notably called Compelling Evidence 3.0 (CE3.0), allow merchants to protect themselves against confirmed first-party misuse by leveraging structured transaction data.

In this paper, Verifi conducts a global assessment of how merchants are thinking about first-party misuse and fraud, their attitudes, challenges, and strategies towards optimizing data to manage first-party misuse disputes, and how card brands are stepping up to level the playing field across the entire post-purchase ecosystem.

> **How we define first-party misuse:**
>
> First-party misuse, also known as "friendly fraud", occurs when a cardholder disputes a legitimate charge and claims it's fraudulent.

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[1] https://www.forbes.com/sites/louiscolumbus/2020/05/18/how-e-commerces-explosive-growth-is-attracting-fraud/?sh=50d27d4c6c4b

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What is First-Party Misuse ?

Commonly referred to as "friendly fraud," first-party misuse is fraud that is committed when a customer purchases and receives a product or service, then claims the order was placed fraudulently.

The problem caused by friendly fraud has only escalated since the rapid increase in online and mobile ordering between 2020 and 2021. From March 2020 to March 2021, Visa card-not-present (CNP) transactions grew 39%. During this same period, Visa CNP disputes increased by 22%.[2]

First-party misuse presents itself differently for each merchant. In the case of unintentional first-party misuse, commonly caused by unrecognizable or confusing merchant descriptors or charges on a customer's billing statement, this type of misuse can easily be solved by merchants providing more transaction transparency.

Other types of first-party misuse are more intentional and may be presented as a customer attempting to receive goods or services for free.

Challenges for Merchant Verticals

Each vertical has unique challenges that lead to friendly fraud.

Travel

The travel industry can be disrupted by changing schedules, weather delays, and seasonality trends. Disruptions often lead to disgruntled customers. In addition, some add-on purchases can be forgotten leading to cardholder confusion. Both of these scenarios can lead to illegitimate disputes, adding financial risk and operational strain.

When consumers suddenly cancel reservations, or travel delays lead to downstream scheduling issues, cardholders sometimes contact their issuing bank and file a dispute in an attempt to get a refund on non-refundable charges.

Retail

Retailers experience illegitimate disputes from customers who forget purchases, experience shipping delays, feel dissatisfaction with the product, buyer's remorse, or are simply attempting to obtain free goods.

Merchants are often excluded from the dispute creation until it's too late. This prevents merchants from saving the customer relationship or recovering the merchandise or funds. More often than not, friendly fraud creates illegitimate disputes for retailers leading to operational strain and increased financial risk.

Digital Goods & Services

Digital goods and services are often purchased on accounts shared by families with multiple authorized users. This can lead to purchase confusion when the primary cardholder reviews their credit card statement, resulting in erroneous disputes.

Merchants employing subscription models often see illegitimate fraud disputes from buyers who forget to cancel service and see disputes as the easiest way to recoup funds or obtain free goods and services.

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[2] Visa Internal Reporting

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Research Methodology

We surveyed **1,072 merchants globally**, doing business in physical goods and retail, travel and tourism, digital goods, and entertainment industries

To qualify, individuals were screened for involvement in eCommerce fraud management, payment management, payment analytics, business intelligence, and dispute or chargeback management at survey respondent's company.

Quotas were set by region and merchant size based on annual ecommerce revenue (<$5M = small business, <$50M = mid-market, >$50M = enterprise).

Fieldwork was conducted throughout October and November of 2022.

Overview of Key Insights

Over

one-third of merchants

believe they experience first-party misuse, with Enterprises reporting a significant rise in this form of fraud.

Roughly

9 in 10 merchants

submit compelling evidence to resolve friendly fraud disputes, but only 7 in 10 are aware of card brands' recent updates to these policies. Those that are aware are optimistic these updates will help.

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Tackling First-Party Misuse

First-party misuse is still one of the most prevalent forms of fraud, ranking as the 2nd most common type of fraud, its incidence marked by 34% of merchants globally.

Over one-third of merchants experience first-party misuse, with Enterprises reporting a significant rise in this form of fraud. More than 6 in 10 (62%) experienced an increase in this form of fraud over the past year.

34%
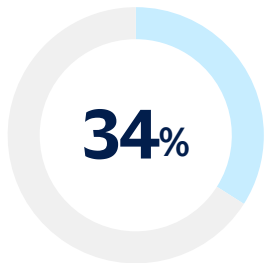
...of merchants have **experienced first-party misuse (friendly fraud)**.

Incidence of friendly fraud has increased among enterprises (+10%)

18%
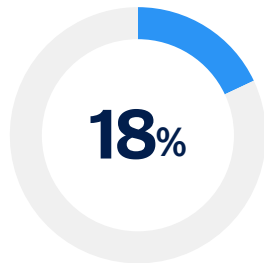
...of all fraudulent disputes should be attributed to **first-party misuse** as reported by merchants.

$35*

...**is the estimated cost** for a merchant to manage friendly fraud (for every $100 in disputes).

*Trimmed average shown

62%

...of merchants **report an increase in friendly fraud disputes since 2021.**

More so for those in APAC (72%).

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Causes of First-Party Misuse

Attempts to obtain free goods/services and transaction or descriptor confusion remain the most common drivers of friendly fraud disputes. Merchants attribute recent increases mainly to inflation and rising sales/demand.

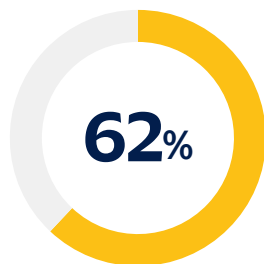## Common Types of First-Party Misuse (Drivers for Submitting Disputes)

(among N=210 experiencing friendly fraud – data overall and for cross-breaks is largely similar from 2022 to 2023)

58%
Attempt to obtain free goods or services

47% ↓ North America (35%)
Transaction or descriptor confusion

40% ↓ Europe (19%)
Friendly fraud

40%
Transaction amount confusion

36%
Wanting to return goods outside of your company's return period

36%
Wanting to return goods outside of your company's return period

35%
Buyer's remorse

27% ↑ APAC (50%) ↓ SMB (11%)
Quality of goods not as expected

Reasons for Increasing First-Party Misuse Disputes (since 2021)

(among N=131 citing an increase – new to 2023 survey)

52%
Inflation / higher prices

50%
Increase in eCommerce sales / demand

41%
Changes to cardholder protections on accepted payment cards

39%
Changing / adding new eCommerce customer bases

34% ↑ APAC (58%)
Changing / adding new eCommerce system or payment solution providers

31%
Changing / adding new eCommerce sales channels

↑ = Signals Higher than 2022
↓ = Signals Lower than 2022
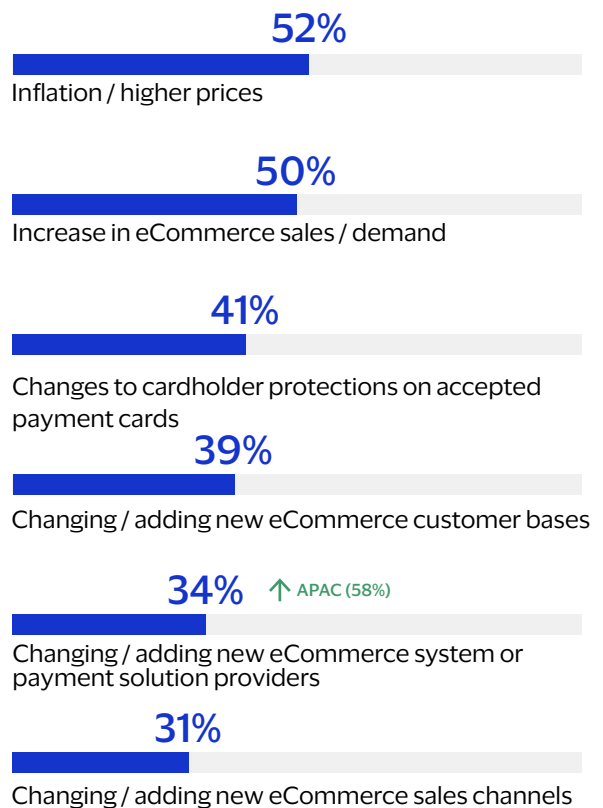
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Top strategies used by merchants to prevent and mitigate first-party misuse include notifications, flagging and checking, and verification and identification. Enhanced requirements are also utilized by about 6 in 10.

Current Approaches to Combat First-Party Misuse

48%

Revoking access to services / purchases
for customers who file chargebacks

47% ↑ (+13%)

Making cancellation and return policies
clear and easy to find on website

46%

Requiring Card Verification Values
(CVV) codes to process card payments

45% ↑ (+18%)

Monitoring & analyzing transaction data
for unusual activity or anomalies

43%

Checking customer purchase and order histories

41%

Filing formal disputes on fraudulent
chargebacks with financial partners

40% ↑ (+14%)

Blacklist customers who file chargebacks

40% ↑ (+13%)

Working with providers to prevent or
identify fraudulent transactions

38% ↑ (+12%)

Notifying customers when orders are
processed / delivered

37%

Verifying billing addresses entered match
billing addresses for cards used

36%

Reviewing & analyzing non-fraud chargebacks and
declines

32%

Notifying customers after processing their payment

30%

Requiring signature on delivery

30%

Notifying customers before processing their
payment

27%

Prioritizing certain types or categories
of chargebacks to fight

81%
Notification & Visibility

73%
Flagging & Checking

73%
Verification & Identification

59%
Enhanced Requirements

53%
Filing & Fighting

↑ = Signals Higher than 2022
↓ = Signals Lower than 2022

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Approach to & Perceptions of Compelling Evidence to Resolve First-Party Misuse Disputes
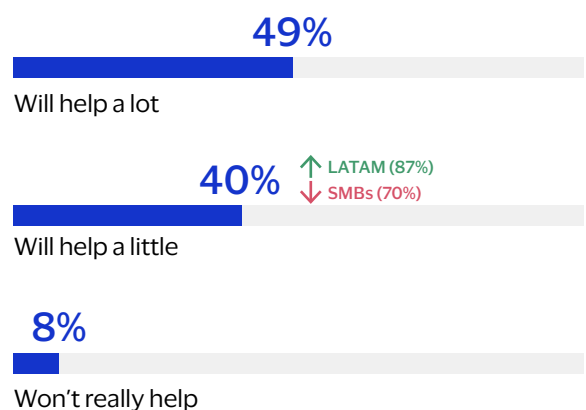
Roughly 9 in 10 merchants submit compelling evidence to resolve friendly fraud disputes, but only 7 in 10 are aware of card brands' recent updates to these policies. Those that are aware are optimistic these updates will help.

Merchants in Europe are less aware and also less optimistic about these updates, while those in LATAM and SMBs are more optimistic.

Approach to Compelling Evidence

89%

Submit compelling evidence to respond to first-party misuse disputes.

72% ↓ Europe (58%)

Are aware of major card brands' updates to compelling evidence policies.

89%

Collect and store the necessary data to take advantage of these updates.

(i.e. 12 months of transaction data, IP address, device fingerprint, item info, customer account, delivery address)

Perceived Impact of Major Card Brands' Updates to Compelling Evidence

49%

Will help a lot

40% ↑ LATAM (87%)
          ↓ SMBs (70%)

Will help a little

8%

Won't really help

89% **think these updates will help** solve or reduce the problem of first-party misuse.

↑ = Signals Higher than 2022
↓ = Signals Lower than 2022

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Incidence of Fraud Management Challenges

Globally, merchants have faced increasing challenges related to managing card-not-present transaction disputes.

The greatest challenge is effectively using data to manage fraud, a struggle that is likely related to the secondary challenge of keeping up to date on the rule changes by payment card networks.

Top Fraud Management Challenges Experienced in the Past 12 Months

■ 2023 (N622)　■ 2022 (N677)　■ 2021 (N650)

	Effectively using data to manage fraud	Keeping up to date on rule changes by payment / card networks	Lack of sufficient internal resources	International expansion
2023	38%	32%	24%	21%
2022	29%	31%	22%	19%
2021	30%	32%	23%	24%
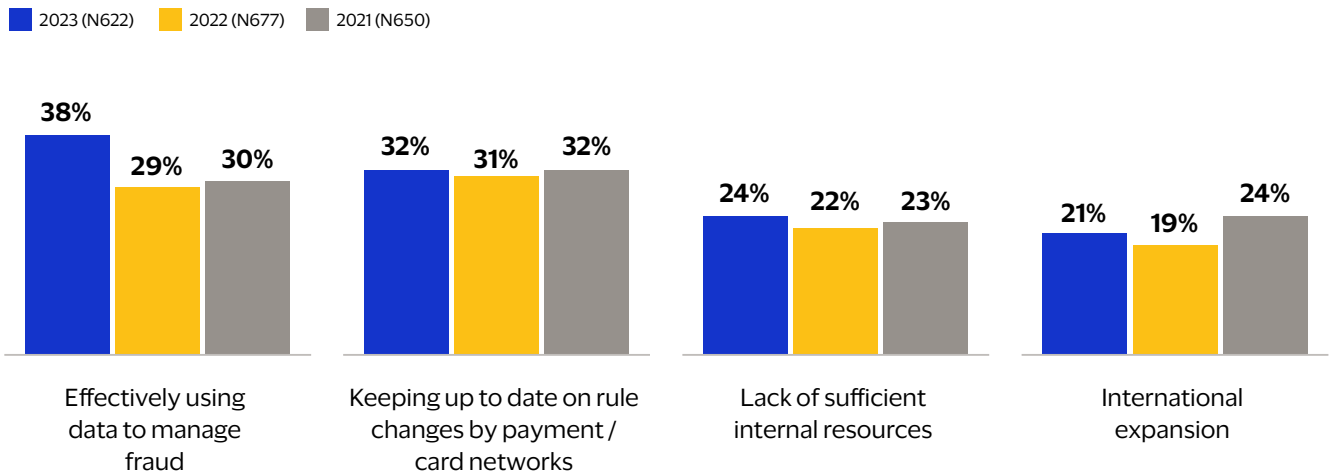
Card Brand Updates for card-not-present Fraud Disputes

Effective as of April 15, 2023, updates to Visa's compelling evidence requirements for card-not-present fraud disputes give merchants the opportunity to provide additional data as evidence to show that the disputed transaction is a valid charge. With the submission of relevant data, the cardholder-initiated dispute becomes invalid.

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How Merchants Can Leverage the Compelling Evidence Updates

Visa's approach to required data elements is to give the payments ecosystem the confidence the cardholder participated in the transaction and has an established relationship with the merchant. To establish a historical footprint, merchants must submit structured Transaction Data from two prior eligible transactions.

Required data can be submitted either prior to the initiation of a dispute, or after a dispute has already been filed. When an inquiry is raised, enhanced data sharing solutions like Verifi's Order Insight® instantaneously relay all the merchant's captured data points directly back to Visa in the pre-dispute phase – preventing the dispute from being filed or factoring into the merchant's fraud ratio.[3] Alternatively, merchants can manually leverage data in the post-dispute phase as part of a pre-arbitration response; however, if the data sharing occurs post-dispute, the dispute will still be factored into the merchant's dispute ratio.

Structured Transaction Data

1. IP Address or Device ID / Fingerprint
2. ONE of the following:
   - Customer Account / User ID
   - Shipping Address

Eligible Transactions

- 120 to 365 days older than the disputed transaction
- Disputed or non-disputed transactions void of prior fraud activity or claims
- A merchant match

Benefits of leveraging Order Insight for pre-dispute CE3.0 support:

Merchant **retains revenue** from transaction

Successful dispute deflection will **not count against fraud dispute ratio**[1]

Reduces dispute-related costs including fees and fines

Lowers the **operational cost** of managing disputes

Benefits of leveraging pre-arbitration for CE3.0 support:

Control which historical transactions to submit as compelling evidence

Reverse dispute from impacting fraud ratio

Respond to disputes the **same way you do today,** through your acquirer

Maximize revenue retention through successful representment

[3] Acquirers may have their own risk assessment parameters, and may levy fees based on such parameters regardless of a merchant meeting Visa's dispute ratio target

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Conclusion

The rise in first-party misuse disputes coincides with relief from card brands and dispute deflection solutions that can help merchants better understand and leverage compelling evidence updates to reduce the incidence of friendly fraud.

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