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Chargebacks explained

The clear, concise guide to chargebacks.

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Key premise

In this whitepaper we explain what chargebacks are, the chargeback process and the key reasons for them.

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01. WHAT ARE CHARGEBACKS

As the name suggests, a chargeback is a literal charging back of the fees that a merchant was paid from the card holder for a product or service provided. This is usually initiated by the credit card provider. The cardholder's issuing bank places a demand on the merchant's acquiring bank to recoup either part of, or more often, the entirety of the transaction, on behalf of their card holder. The acquirer is obliged to transfer these funds from the merchant's account so that the cardholder may be compensated. When a cardholder places a transaction on their credit or debit card, they are entitled to certain protections.

Many of these protective clauses and guarantees are meant to ensure that the cardholder is protected from merchant fraud. A key component of this is the cardholder's right to dispute a transaction for a variety of reasons ranging from non delivery of goods, goods not being as advertised, or potential card fraud. A cardholder may contact their issuing bank to log a complaint or advise the bank that they do not recognize or authorize a certain transaction. The cardholder is usually afforded a six month window in which to initiate this action.
In order to maintain some control over the type and quality of their merchants, card schemes (Visa, MasterCard, etc.) actively monitor merchant chargebacks to successful transaction ratios. As a rule of thumb, a merchant must maintain a chargeback to successful ratio of less than 1%.

In order to breach either Visa or MasterCard's acceptable chargeback thresholds, a merchant would need to meet both of the following criteria in a single calendar month: 100 or more chargebacks and a positive transaction to chargebacks ratio of 1% or greater. If both of these thresholds are met, the merchant is considered to be in breach. This can lead to actions ranging from costly fines, to a ban on accepting payments from a card scheme, to being placed on a blacklist for years. Due to this, it is imperative that a merchant maintain a chargeback monitoring and mitigation program.

02. THE CHARGEBACK PROCESS

1. The cardholder initiates a dispute for a transaction This can be caused by a number of factors. See the following page for more details.

2. The issuer sends the transaction back to the acquirer electronically They make a demand for the full or partial amount of the transaction on behalf of the cardholder.

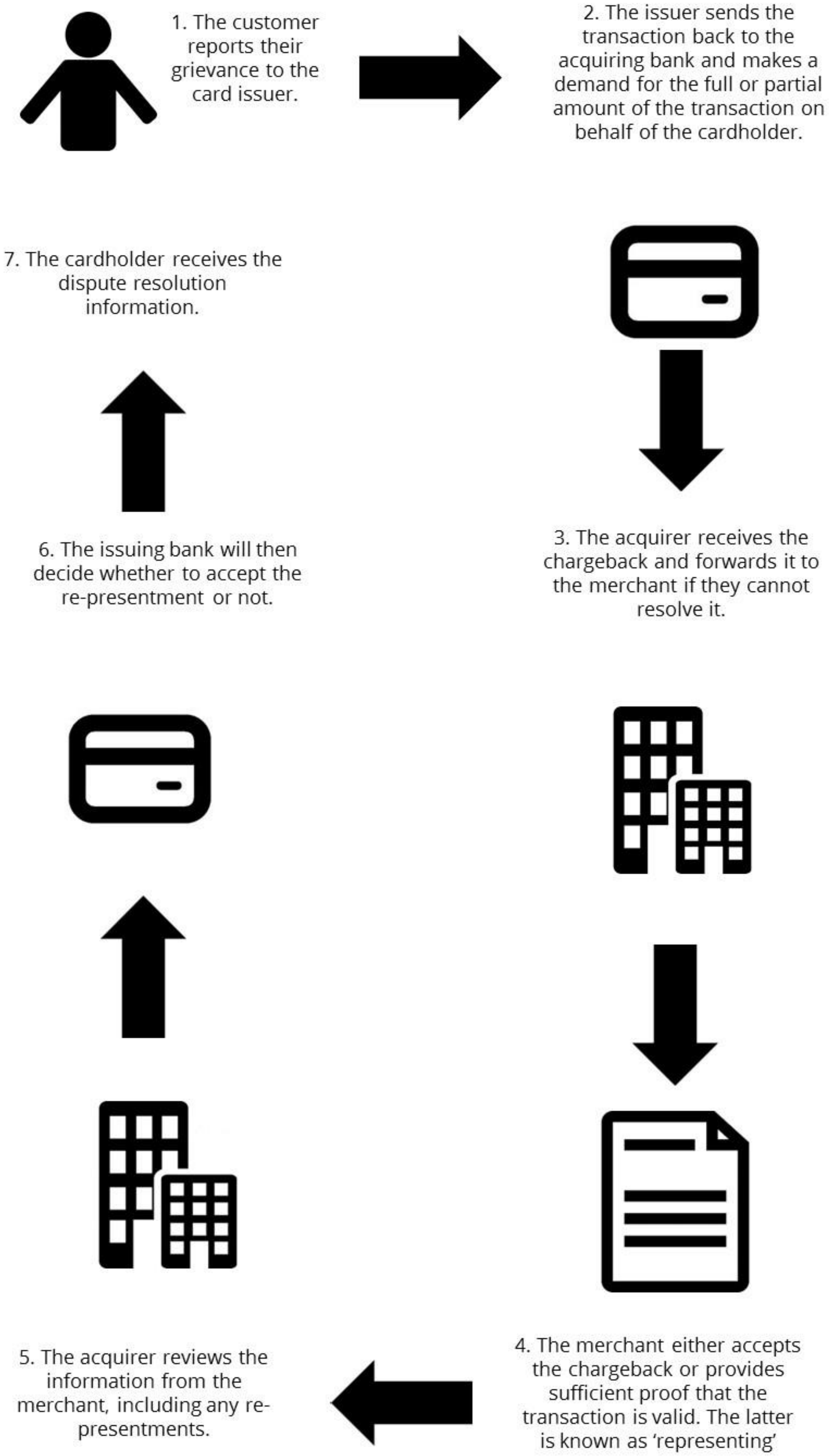
3. The acquirer receives the chargeback The acquirer then forwards this to the merchant. This includes deducting the funds from the merchant's account so that the card holder can be credited.

4. The merchant either accepts the chargeback or represents The merchant either accepts the chargeback or provides sufficient proof that the transaction is valid. The latter is known as 'representing' and disputes the chargeback claim.

5. The acquirer reviews the information from the merchant If a representment is requested, then the acquirer will submit a request for funds to be debited from the card holder's account so they can be credited into the merchant's account.

6. The issuer will then decide whether to accept the representment or not If they wish to proceed with the chargeback, this is known as prearbitration. This counts as a second chargeback.

7. The cardholder receives the dispute resolution information From here, they are either either rebilled for the amount of the item in question, or credited for the item in question depending on the outcome of the dispute.


1. The customer reports their grievance to the card issuer.
2. The issuer sends the transaction back to the acquiring bank and makes a demand for the full or partial amount of the transaction on behalf of the cardholder.
3. The acquirer receives the chargeback and forwards it to the merchant if they cannot resolve it.
4. The merchant either accepts the chargeback or provides sufficient proof that the transaction is valid. The latter is known as 'representing'
5. The acquirer reviews the information from the merchant, including any re-presentments.
6. The issuing bank will then decide whether to accept the re-presentment or not.
7. The cardholder receives the dispute resolution information.

03. MAIN REASONS FOR CHARGEBACKS

Certain industries are more prone to chargebacks than others. These are often known as high risk merchants. Chargebacks are predominantly initiated by cardholders. Here are the main reasons a chargeback may occur:

Item or service not delivered to customer

Not receiving an item can also be cause for chargebacks, and is very common. The furniture industry is particularly at risk here.

Technical issues

There may be technical issues at large at any point during the payment process. Technical problems include duplicate processing and problems with authorisation.

Credit not processed

This occurs when the customer returns a product to the merchant (for instance a damaged item or one different to the description). If the credit is not returned to them after requesting this to happen, the merchant is held liable. The merchant will then be charged for this problem.

Faulty credit card

The merchant is not held liable for this occurrence, as it's beyond their control.

Item not as described

If the item is received and it is completely different to how it has been described, then the customer is able to ask for a refund and return the item. See 'Credit not processed' above.

Incorrect amount charged

If the customer is billed the incorrect amount for the service or product. In this case, the blame lies with the merchant.

04. CHARGEBACKS AND FRAUD PREVENTION

In a perfect world, and for many merchants, the card scheme's chargeback program is not an issue, after all, it is intended to protect card holders from unscrupulous merchants. But what protects merchants from unscrupulous card holders? There are merchants that should provide better customer service and adhere more closely to best practices. Others are merchants who, weather due to their sector or model, find that they seem to attract chargebacks.

A common scenario is one in which the card holder joins a dating service. After several months, they develop 'buyer’s remorse'. Instead of contacting the merchant, they feel it easier to simply call their card issuer and claim that they are unfamiliar with these charges, or did not authorise them. The issuer is likely to, in turn, issue a chargeback. Not just one, but for all the months the individual was a member. From the merchant’s perspective they are receiving several chargebacks from a single cardholder for a service they provided in good faith. This scenario of a cardholder initiating a chargeback for a service or good they did receive is usually referred to as 'friendly fraud'. For many merchants, friendly fraud is a massive problem costing money, time, resources, and can potentially threaten the existence of their business.

The merchant is not without recourse. If the merchant feels that they have been unduly deprived of the funds for the transaction, they may proceed with what is referred to as a 're-presentment'. For the initial transaction, the merchant presents the request for payment to the issuing bank in order to collect the funds from the card holder's account. Due to the card holder's chargeback, the merchant is now 'representing' that request. This action will result in the cardholder's account being debited and the merchant's account being credited.

Although the card schemes assign a fortyfive day window for representments, the acquiring bank typically allow about fifteen days for the merchant to file this action. This limit is meant to help accommodate for all the back office activity that occurs in association with a re-presentment. As there are costs involved with both chargebacks and representments, a merchant would be wise to ensure that they have sufficient proof that they are entitled to the fees as they claim.

Due to these reasons, it is important that the merchant has a program in place that collects details that may be useful should a dispute arise. It is also important that the evidence provided during a representment relates to the reason for the chargeback. It is no good providing proof that goods were delivered if the chargeback reason code is for the product not being as advertised.

05. SECOND CHARGEBACKS

If, despite the evidence provided by the merchant, the cardholder feels they still have a valid dispute, they may file what is referred to as either a 'second chargeback' or 'prearbitration'. Again, the funds are debited from the merchant's account and credited to the cardholder. The main difference about a second chargeback is that if the merchant still feels they are entitled to the funds, the case will be determined by a card scheme arbitrator. The card scheme ruling is final. In order to proceed at this stage, a merchant should feel very comfortable that they have sufficient evidence to succeed in arbitration. The penalty for losing the dispute is currently over €500. The chargeback process can be long, cumbersome, complicated, and costly. Axcess is here to assist in several ways. Our chargeback managing service includes:

- Monitoring chargeback counts and ratios.
- Creating a strategy with the merchant to ensure that they maximize chargeback avoidance.
- Offering a host of chargeback mitigation solutions.
- Ensuring effective communication with acquirers.

Chargebacks can be complicated. However, Axcess provide a service that can navigate this difficult process.

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