Q4 2022 DIGITAL TRUST & SAFETY INDEX

The rising risk of online disputes

Contents

Uncovering the total threat of disputes

The global economy is peering down a precipice of change. As inflation rises and geopolitical risks soar in response to the Russia-Ukraine war, financial conditions are uncertain, sparking fears of a global recession. Economists forecast global growth to slump from 3.2% in 2022 to 2.7% in 2023—with many businesses already feeling the impact.

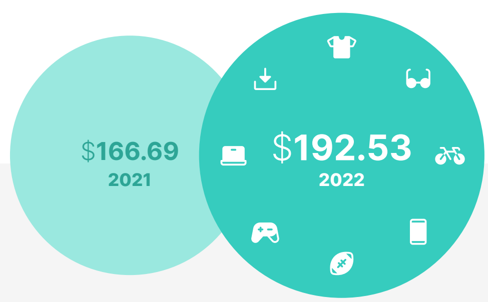
In the midst of this mass disruption, companies of every size are looking to cut costs, causing a chain reaction of belt-tightening across markets. And based on data from past economic downturns, we know businesses will face rising fraud on top of it all. As leaders strategize what it will take to safely navigate these challenging times, it will be crucial to identify and plug leaky revenue.

Chargebacks are a universal source of frustration for many companies looking to control profit loss, as they're uniquely unpredictable and easy to exploit. Economic uncertainty only makes this worse, leading to changeable consumer behavior and increased fraud rates. According to Merchant Fraud Journal, merchants are expected to pay over $100 billion in chargebacks in 2023.

Merchants are already seeing rising disputes this year. Across the Sift network, **dispute rates increased 35%** in Q3 2022 versus Q1 2022. In addition to the rising rate of disputes, the average disputed dollar amount is also higher than last year—**increasing 16% to $192.53**. If this upwards trajectory continues, businesses could face even higher fraud rates of costly consequence in 2023.

↗ 35%

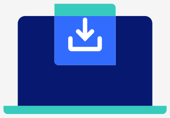
increase in dispute rates in Q3 2022 versus Q1 2022.



$192.53

was the average value of a chargeback in 2022, up **16%** from 2021.

Industries with the highest number of disputes from January–September 2022



1 Digital goods & services

2 Retail

3 Fintech

Not all industries are fighting the same battle when it comes to disputes. Online sites and services, for example, are more susceptible to chargebacks. These card-not-present (CNP) transactions are more likely to result in disputes largely due to the challenges of user verification and the confirmation of delivery.

Unsurprisingly, digital goods & services made it to the top of the list this year, representing the industry with the highest number of disputes from January–September 2022 across the Sift network. Providers in this space struggle to win disputes because they don't have access to much physical evidence, like shipping addresses or proof of delivery.

“Fraudsters are now disputing online purchases using non-fraud reason codes, coupled with fake excuses—like not having received the item they ordered—in the hopes of fooling credit card companies.

Brittany Allen, Sift Trust and Safety Architect

71.5%

of disputes were labeled "fraud" by the cardholder from January–September 2022 across the Sift network.

Across the Sift network, nearly **three-quarters of disputes were labeled "fraud"** from January–September 2022 by the cardholder initiating the chargeback. But this figure isn't what it appears. Digging deeper into these dispute breakdowns, we can see there are more complex factors at play. Although reason codes cover various scenarios such as duplicate processing, authorization issues, or canceling a recurring bill, consumers may be using the "fraud" reason code improperly. These disputes may be labeled fraud by the consumer, but in reality a significant proportion may be **first-party fraud** (also known as friendly fraud).

Results from Sift's consumer survey* show **23% of consumers who have disputed a purchase admit to participating in first-party fraud**, during which they file a fraud dispute for a transaction they made even though there was nothing wrong with the purchase. And because this only represents self-proclaimed first-party fraudsters, the real figure is likely much higher.

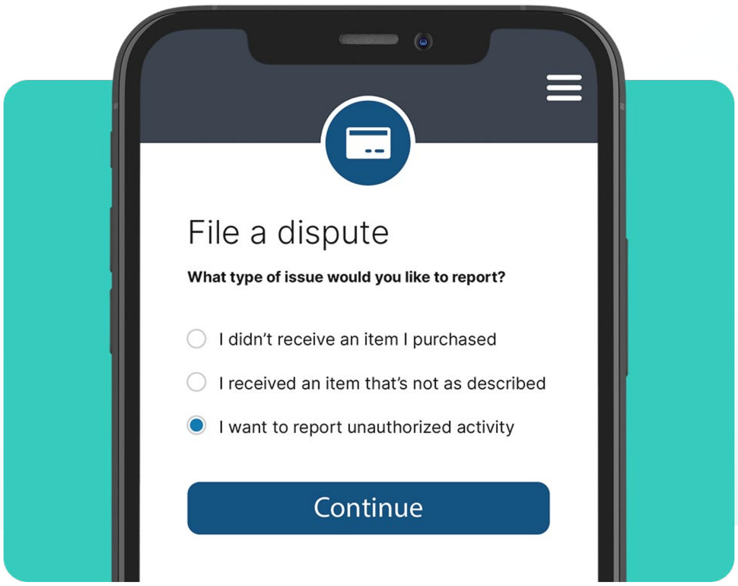
Alternative payments face unique chargeback challenges

Some businesses using alternative payments, such as cryptocurrency, are dealing with new challenges when it comes to disputes. Although crypto transactions aren't subject to chargebacks, disputes can still be made on ACH transfers and credit card transactions. This could involve using a stolen credit card to buy crypto, a scam victim trying to recover their money, being regretful over losses, or trying to bypass poor customer service.

**On behalf of Sift, Researchscape International polled 1,179 adults (aged 18+) across the United States via online survey in October 2022.*

23%

of consumers who have disputed a purchase have filed a chargeback in the last year using fraud as the reason for doing so, even though they received the item and were satisfied with the purchase.



Although some consumers admitting to first-party fraud may have malicious intent from the start to keep both the item and their money, there are a variety of other reasons that could account for this behavior. The dispute could have been initiated inadvertently, or the consumer may have not recognized the purchase on their statement, missed the return window, or regretted the purchase and needed the funds to cover other essentials instead.

Many businesses may have a suspicion that a high percentage of disputes flagged as fraud are in reality first-party fraud, but lack the solutions to accurately sift through them. Merchants know the likelihood of winning truly fraudulent disputes is next to impossible, and won't waste their time or effort fighting them. But if those chargebacks could be more accurately categorized, risk teams would be able to better prioritize win-worthy disputes.

Luckily for merchants, fighting first-party fraud is about to get a lot easier. Visa is updating their compelling evidence rules that could help merchants win more disputes, and shift liability away from merchants. To do so, a merchant must submit details of a pattern of prior, legitimate transaction history to help prove the cardholder participated in the purchase. These transaction details must be any two of the following four: IP address, device ID or fingerprint, shipping address, and account login, but at least one must be the IP address or device ID. Starting April 2023, the Visa CE3.0 compelling evidence revamp will be a game changer to help businesses better defend against first-party fraud.

Breaking down the true cost of chargebacks

Disputes are so commonplace that **two out of three (66%)** consumers surveyed by Sift have filed at least one in their lifetime. There are multiple factors that make chargebacks such a significant problem for merchants—they're difficult to predict, time-intensive and complex to manage, and an operational burden for teams already stretched thin.

66%

of consumers have filed a dispute in their lifetime.

Merchants are also at a disadvantage when it comes to the relationship between the customer, financial institution, and themselves. The majority of consumers will file a dispute directly with their credit card company instead of contacting the merchant first, assuming the merchant will make it difficult and time consuming to get their money back.

The biggest hindrance disputes pose to merchants is how costly they are to manage. Because merchants are liable for card-not present purchases by default, they'll lose the transaction amount automatically when the dispute is processed. And for every dollar lost to fraud in 2022, U.S. retail and e-commerce merchants will lose $3.75, up 19.8% since 2019.

Merchants can face fees of up to $40 per chargeback depending on the payment processor, on top of card processing fees between 1%–4%, covering the cost of data transmission, the chargeback itself, and coverage against chargeback exposure for the processor.

In the event the merchant doesn't win the case, they'll also lose the cost of the product or service, time and labor expenses, and any associated shipping fees. If disputes are left unchecked, payment processors could even issue fees and restrictions on merchants who have a chargeback rate of over 1%.

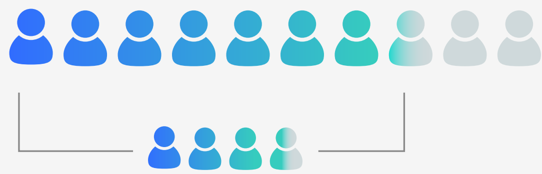
The top three most disputed purchases

Clothing	21%
Subscription goods	19%
Electronics	18%

Adding fuel to the fire, businesses may also face fallout from consumers who were victims of fraud on the merchant's site and had to file a dispute for a purchase they didn't make. The overwhelming majority **(83%) of consumers** who have filed a dispute said they would be less willing to buy something from a brand if they had to file a dispute for a purchase as a result of fraud. And of those consumers, **35% said they'd never buy from that brand again**.

83%

reported they would be less willing to buy something from a brand in the future if they had to file a fraud-driven dispute.



35% of those respondents would be unwilling to engage with that brand ever again.

Consumers are just as frustrated with lengthy dispute resolution processes. The longer a brand takes to resolve the chargeback, the less likely that consumer will want to shop there again. **Half of consumers** said they'd never shop with a brand again if they failed to resolve their dispute within 30 days. Considering how many consumers file disputes, it's crucial to take these high risks of brand abandonment seriously. Companies must take into account customer acquisition cost (CAC) and lifetime value (LTV) to quantify how losing a customer could harm the business.

During economic uncertainty, more consumers may be making credit card purchases during the holiday season only to file disputes on the legitimate purchases in the new year. Some may also be participating in pre-holiday first-party fraud, intentionally filing misleading disputes to free up finances for holiday shopping.

However, this chargeback trend isn't unique to times of economic instability. Because cardholders have up to six months to dispute a charge, it's common to see claims roll in 2–3 months after the initial transaction was processed. Therefore, holiday shopping typically results in disputes being filed between January and March—the industry-standard chargeback season following the holiday spending rush.

Merchants can set themselves up for less first-party fraud in the new year by having clear cancellation and return policies in place for the holidays. Although some merchants are hoping to curb the exploitation of returns by shortening return windows, having a longer return runway can help reduce the number of disputes teams will have to field.

50%

of respondents would never shop with a brand again if it failed to resolve their dispute within 30 days.

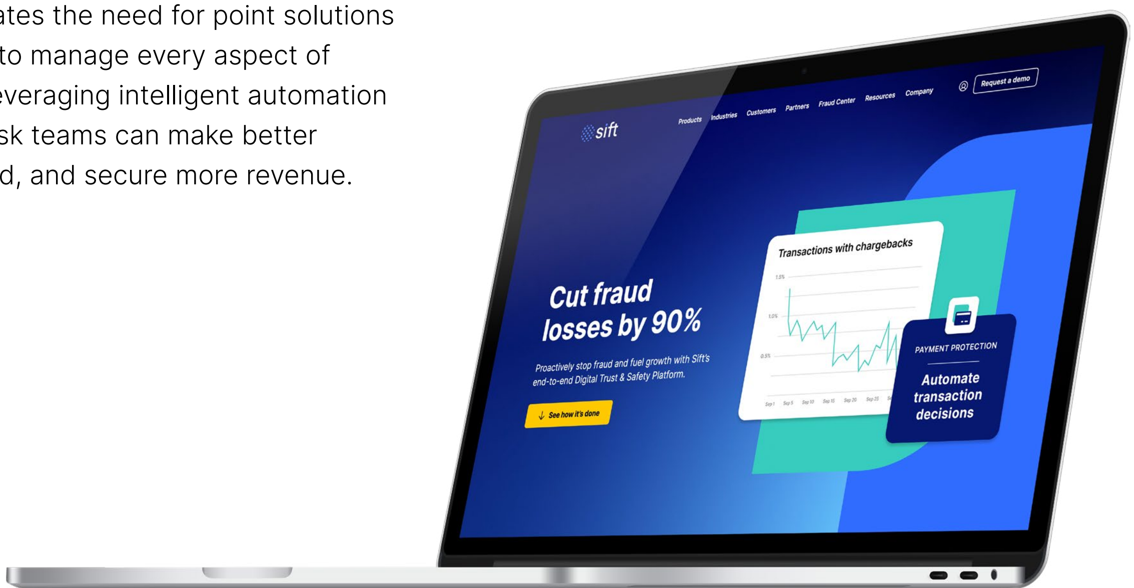
> "Rising disputes amid an economic downturn pose a serious threat to any business's bottom line. Merchants not only need a proactive fraud strategy to protect and recover revenue that would be lost to chargebacks, but they also need to evaluate their end-to-end dispute management process.
>
> **Brittany Allen, Sift Trust and Safety Architect**

Smarter, faster fraud prevention at every touchpoint

Reducing disputes can't be achieved in a vacuum. Fraud is a complex, interconnected problem that requires an end-to-end solution to battle every type of fraud for full protection. Businesses must invest in technology that can proactively prevent account takeover (ATO) and payment fraud to reduce the likelihood of disputes, as well as resolve disputes more efficiently.

The Sift Digital Trust & Safety Platform is the single solution for complete, flexible, and easy fraud prevention. Sift eliminates the need for point solutions with a single platform to manage every aspect of fraud operations. By leveraging intelligent automation at every touchpoint, risk teams can make better decisions, reduce fraud, and secure more revenue.

As the first-ever chargeback solution to use real-time machine learning, Sift helps identify missing evidence and increase win rates with Response Recommendations. With Sift Dispute Management, businesses can streamline chargeback responses and use data-driven evidence recommendations to increase chances of winning against different disputes.



End-to-end intelligent automation with Sift

Sift is the leader in Digital Trust & Safety, empowering companies of every size to unlock new revenue without risk. Our cutting-edge platform dynamically prevents all types of online fraud and abuse with intelligent automation that adapts based on Sift's unrivaled global data network of 70 billion events per month. Global brands including Twitter, DoorDash, and Wayfair rely on Sift to catalyze growth and stop fraud before it starts.

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