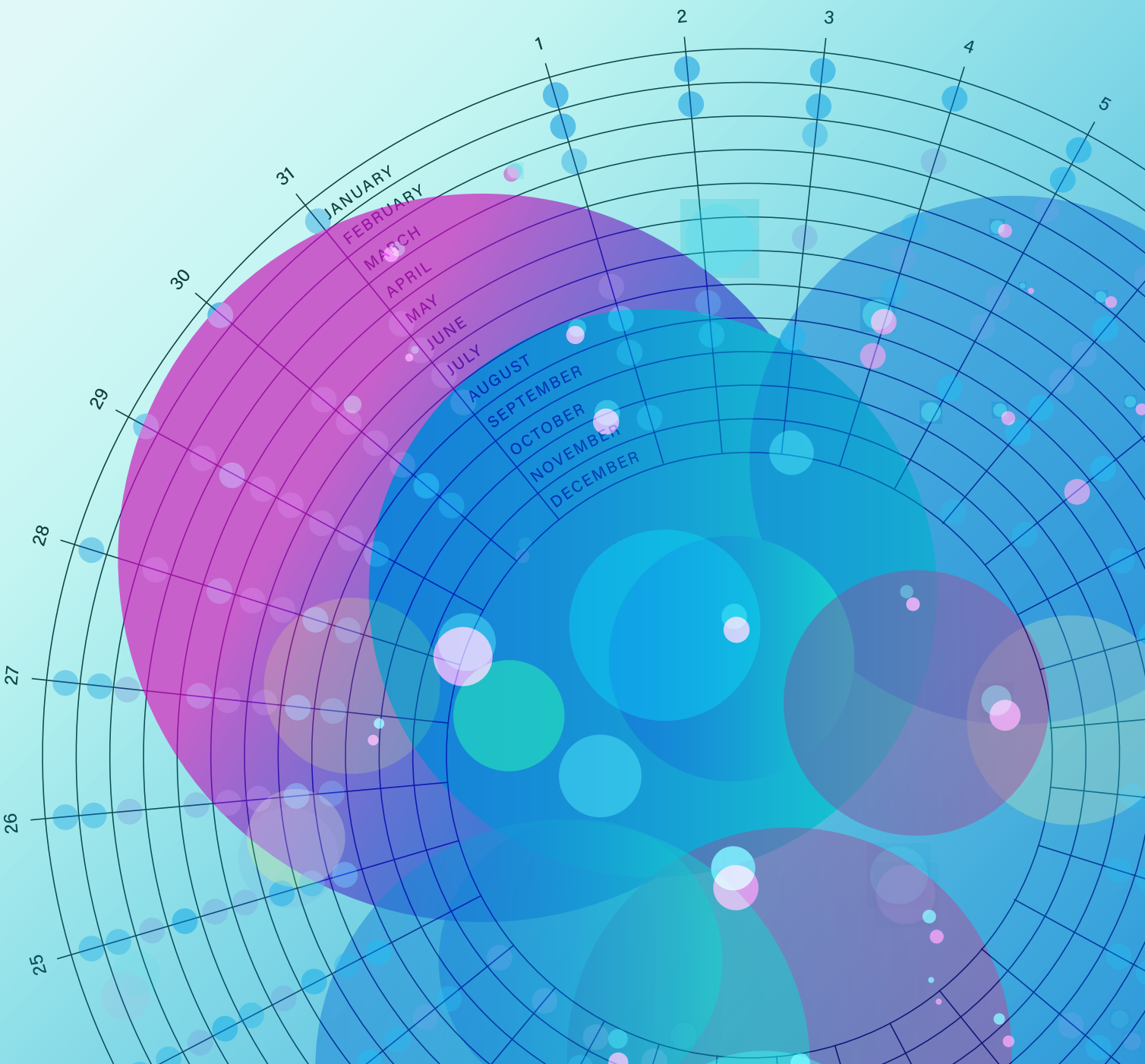
sift

Q4 2021 DIGITAL TRUST & SAFETY INDEX

Navigating the new normal of digital fraud and disputes



Contents

DISPUTES AND CHARGEBACKS

The cost of doing business online

Pandemic-induced digital disruption has redefined how the world does business. As consumers adjust to life in the midst of COVID-19, businesses must adapt to the new realities of digital commerce and the fraud that inevitably follows. Online transaction volumes have skyrocketed since the start of the pandemic, and the Fraud Economy continues to run rampant with cybercriminals prepared to launch attacks at every touchpoint.

The average number of daily chargeback cases rose by 19% between Q1 2020 and Q1 2021.

65% of consumers surveyed have disputed a purchase in their lifetime.

Chargebacks certainly aren't going away anytime soon. Well over three-quarters (**86%**) of consumer respondents indicated they were likely to file a dispute again in the future, illustrating just how commonplace the practice has become. But for merchants, more disputes mean ballooning operational costs, on top of exorbitant fees from payment networks that can lead to revoked payment options.

In the digital-first economy, disputed purchases and resulting chargebacks are the cost of doing business online. Of consumers surveyed by Sift*, **65% reported having disputed a purchase** in their lifetime—**62%** of whom have done so in the past year, most commonly stemming from digital transactions. And the number of digital disputes being filed is rising. Across the Sift network, average daily chargeback cases (the number of disputes filed), increased a significant **19%** between Q1 2020 and Q1 2021, in line with the steady YoY growth in transactions across digital markets.

BRITTANY ALLEN, *Trust and Safety Architect at Sift*

"Credit card companies usually provide a positive resolution for the consumer in order to increase customer satisfaction. Because consumers know their payment providers will take their side, there's little to stop them from filing chargebacks whenever they feel inclined.

*On behalf of Sift, Researchscape International polled 1,231 adults (aged 18+) across the United States via online survey in October and November 2021.

of consumers surveyed said they are likely to file a dispute again in the future.

While some research suggests only 25% of disputes filed are the result of fraudulent purchases (i.e., true fraud), consumers surveyed by Sift reported nearly double the digital abuse—**42%** of respondents who filed disputes did so due to unauthorized purchases made with their payment information. When asked separately, **17%** of those who have filed chargebacks admitted to filing a fraud dispute for a transaction that wasn't actually fraudulent—a practice known as friendly fraud in which the person committing fraud is actually the legitimate cardholder.

Common Reasons for Filing Disputes*

42%	reported purchases were fraudulently made using their payment information
23%	wanted to cancel a recurring subscription
21%	claimed item or service wasn't how it was described
19%	claimed item or service never arrived or arrived late (potentially due to recent supply chain issues and shipping delays)
18%	were owed a refund due to a complaint or cancellation, but didn't receive one

*Respondents were allowed to select multiple answers.

Where Consumers File the Most Disputes

26% Omnichannel retailers

24% E-commerce

19% Other (ATM withdrawal, online misc.)

16% Streaming entertainment services

16% Gaming sites

12% On-demand services

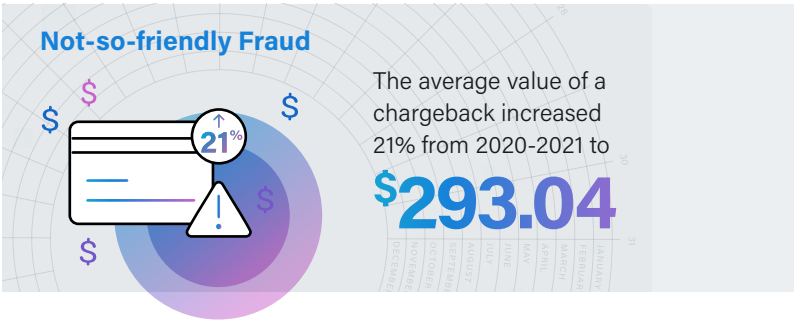
10% Financial services

10% Travel and hospitality

The vast majority of respondents reported filing disputes with digital sites and services. These card-not-present (CNP) transactions are more likely to result in disputes largely due to the challenges of user verification in a digital environment. And with global online spending expected to continue in an upward trajectory, Sift Trust and Safety Architects predict a steady upswing in fraud and disputes in the coming years.

Measuring the true cost of disputes

Chargebacks are not unique to one industry. As businesses rush to meet consumers' accelerated demand for digital shopping, rising disputes are a given. However, moving operations online is a double-edged sword—while it offers flexibility to retailers and consumers, it can open up new possibilities for attack from fraudsters. It also comes with a fraud liability shift—while card-present disputes put the responsibility for fraud losses on the issuing banks, the liability flips to the business with card-not-present purchases—meaning the merchant is guilty until proven innocent.



Whenever a customer's bank processes a dispute, the merchant automatically loses the transaction amount, leading to the immediate loss of revenue. Merchants are also hit with fees ranging up to $40 per chargeback depending on the payment processor, with high-risk merchants paying considerably more. Plus, businesses are on the hook for credit card processing fees between 1% and 4% when the dispute happens, which cover the costs associated with data transmission, the chargeback itself, and coverage against chargeback exposure for the processor. **And unless the merchant wins, the business is out the cost of the product or service, time and labor costs, and potential shipping fees**. Proactive fraud prevention is crucial to maintaining a healthy bottom line.

Payment processors are also becoming more strict about companies' chargeback rates, issuing fees and restrictions on merchants who have a chargeback rate exceeding 1%. Anything above that is typically labeled 'high-risk' by the processor. And in extreme cases, if a merchant continues to experience a high frequency of chargebacks, card associations like Visa, Mastercard, and American Express may revoke the merchant's ability to process payments using that card type—severely limiting their ability to serve a broad range of customers.

The accumulation of all these costs, coupled with a high chargeback rate, can crush a business' bottom line. In fact, for every dollar lost in a fraud attack in 2021, U.S. retail and e-commerce merchants will lose $3.60, up 15% since prior to the pandemic in 2019.

More than half (**57%**) of consumers understand the financial responsibility of disputes falls on merchants, as it's typically weak security measures that enable fraud to happen in the first place. However, despite knowing merchants will ultimately pay the price, **54%** of consumers surveyed contacted their bank or financial institution first when they became aware of an unauthorized charge. In these cases, over half of customers decided to bypass the merchant to file a dispute because it's faster, easier, and more efficient to go straight to their financial institution.

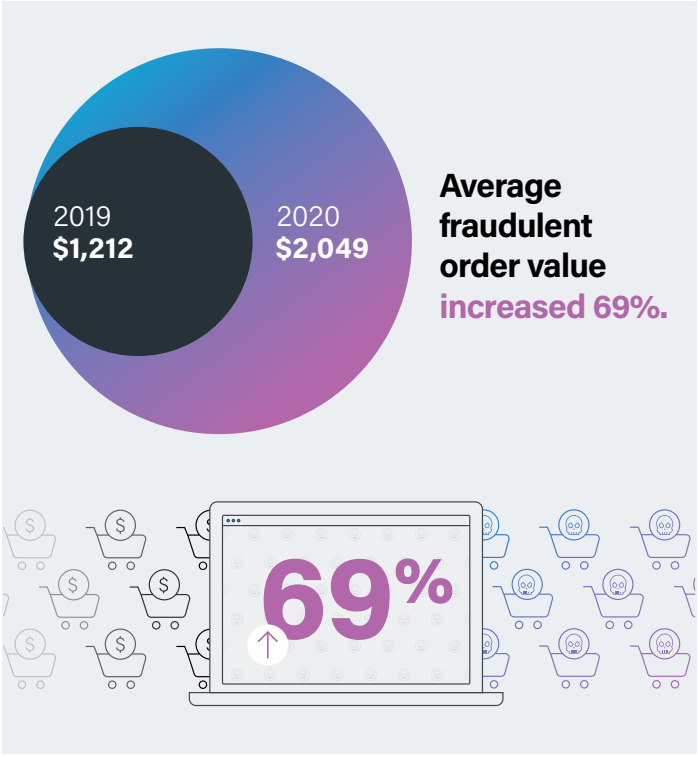
BRITTANY ALLEN, *Trust and Safety Architect at Sift*

Despite a merchant's best efforts to build trust and rapport, they are unlikely to have a relationship as established as consumers have with their credit card company. When given the option, the majority will opt for easy, online disputes with their credit card company over initiating a direct complaint with the merchant, which might involve long wait times and potential conflict.

These varied factors paint the future of chargebacks clearly—it's a problem that plagues nearly every industry and doesn't have one simple solution. Ultimately, the responsibility falls on the business to prevent and manage disputes, and the consequences of failing to get chargebacks in check are too numerous, and potentially harmful, to ignore.

Surging fraud rates lead to disputes

In the rampant Fraud Economy, fraud abuse and disputes have a symbiotic relationship. The global disruption caused by the pandemic gave fraudsters fluctuating online transaction volumes to hide behind, more data to steal, and a growing number of accounts to take over, leading to the proliferation of online abuse. Fraudsters seized on ballooning online consumer spending, driving the average value of attempted fraudulent purchases across the Sift network up by 69% between 2019 and 2020.



Average fraudulent order value increased 69%.

Fraud rates haven't dipped back down to pre-pandemic levels, either, resulting in a staggering 307% increase in blocked account takeover fraud between 2019 and 2021 across the Sift network.

Attempted account takeover fraud skyrocketed by over 3x between Q2 2019 and Q2 2021.

This massive upswing in attempted ATO was blocked throughout the Sift global network, but our trust and safety experts note that the increase is reflective of e-commerce as a whole. Our data illustrates that these attacks were coordinated and worldwide, and extremely likely to have impacted merchants and consumers outside of Sift's umbrella—giving fraudsters access to countless user credentials and the associated payment information needed to make unauthorized transactions.

The rise in online fraud across the board paved the way for an increase in disputes. Once a customer discovers their account has been hacked and their card has been used for illegitimate transactions, they'll demand refunds, store credit, or replacement items, and the liability will fall on the business to eat the cost.

STRATEGIES AND TACTICS

Preventing fraud and reducing disputes

Chargebacks will never disappear altogether, but they don't have to strap your business. Although mistakes happen and some disputes result from merchant error, there are ways to lower dispute rates and mitigate any friendly fraud that arises when a cardholder disputes a legitimate purchase. Teams must reset expectations around manual review and optimize which disputes are worth fighting. Broadly assessing the validity of disputes undermines accuracy, while crafting one-off responses are time consuming, expensive, and a drain on resources. Businesses need to equip trust and safety analysts with the strategic guidance and tools to streamline the process.

Preparing for the seasonality of chargebacks

Cardholders have up to six months to dispute a charge, but it's typical to see claims roll in 2-3 months after the initial charges were processed. Due to this leeway, holiday purchases typically translate to disputes being filed between January and March—the industry-standard chargeback season following the holiday spending rush.

The holiday season, particularly during Black Friday and Cyber Monday sales, predictably drives increases in revenue each year, and the frenzy of online traffic and spending provides cover for fraudsters. Many merchants adapt risk thresholds to ride out the increase in transaction volumes and incentivize spending, but this consequently makes it easier for fraudsters to infiltrate accounts and siphon funds.

E-commerce holiday sales are projected to rise 11-15% this year compared to 2020. And with 20% of consumer respondents anticipating returning gifts they receive during the holiday season, Sift Trust and Safety Architects expect the Q1 2022 chargeback season to be busier, and more unpredictable, than previous years.

Preventing true fraud

In cases of true fraud, cybercriminals use stolen payment information to make unauthorized purchases that are later disputed by the valid cardholder, eventually costing the merchant. Because merchants are responsible for their users' account security, trust and safety experts advise against fighting true fraud disputes—trying to do so will cost valuable time, money, and resources when the dispute is ultimately unwinnable. To effectively protect against true fraud, merchants must implement a proactive fraud prevention strategy to stop illegitimate purchases from getting through in the first place.

10.5%

of respondents who have filed chargebacks admitted to filing a fraud dispute during the holiday season for a transaction that wasn't truly fraudulent.

Fighting friendly fraud

While true fraud is a growing concern, friendly fraud can account for up to 75% of all chargebacks. Friendly fraud has become the most common cause of chargebacks, largely due to its prevalence and unpredictability. These are the types of disputes merchants can't afford to ignore.

Although some friendly fraud disputes may simply be a result of forgetfulness, family members making unknown purchases, or misunderstandings of return policies, the practice also provides amateur fraudsters a low-risk way to make a transaction and then falsely file a dispute claiming they never received it—also known as chargeback fraud. Typically, these types of disputes **are** worth fighting, because the merchant can gather evidence to prove the invalidity of the dispute.

Unintentional friendly fraud disputes can also be prevented by providing more information to customers and having clear cancellation and return policies. One study found that nearly 25% of disputes could be avoided by giving customers more details to easily recognize purchases. Tools like Order Insight and Consumer Clarity help merchants provide card issuers with transaction clarity to stop invalid disputes, while a more automated approach to dispute management can reduce time spent addressing chargebacks.

Unifying Fraud and Dispute Operations with Digital Trust & Safety

Fraudsters are relentless in their efforts to exploit vulnerabilities in the user journey. And as the Fraud Economy continues to expand in its presence and sophistication, businesses must evolve to outpace it. Fraud operations teams need to think bigger than siloed and disconnected fraud prevention strategies, as they offer a patchwork solution that's reactive, inefficient, and ultimately flawed. In reality, fraud is an interconnected problem that requires an interconnected solution to ensure maximum protection.

By implementing a unified Digital Trust & Safety approach, online businesses can scale fraud prevention strategies at every touchpoint to reduce abuse while maximizing growth. The Sift Digital Trust & Safety Suite offers one centralized, automated solution to reduce overall disputes and make managing chargebacks streamlined and efficient.

Visit our website to access previous Sift data reports, including our Q1 dive into payment abuse, Q2 coverage of spam, scams, and content fraud, and Q3 analysis of account takeover fraud.

A complete fraud solution 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 Twilio, HelloFresh, and Wayfair rely on Sift to catalyze growth and stop fraud before it starts. Visit us at sift.com, or follow us on LinkedIn.