UNDER FRIENDLY FIRE
WHAT IS FRIENDLY FRAUD AND WHY IS IT GETTING WORSE?

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Ecommerce is booming and providing new opportunities for merchants. Yet opportunities also bring challenges and attract fraud.

Anti-fraud agencies working with law enforcement, government, banks, card schemes and merchants to hammer fraudsters and the associated organised criminals have helped drive down overall card fraud figures through new technology and education.

The exception to this is card not present (CNP) fraud, which includes the growing threat of ‘friendly’ or chargeback fraud. Europe is leading the way in friendly fraud growth.

This whitepaper will examine what friendly fraud is and look at why this problem continues to get worse. It will also look at ways that merchants, specifically SMEs, can equip themselves to tackle friendly fraud and protect themselves against financial, operational and reputational damage. It also suggests how card schemes can play their part.

WHAT IS FRIENDLY FRAUD?

No respectable merchant would ever argue that consumer rights aren’t a critical part of business. When a consumer buys from a merchant, it is in everyone’s interests that if the consumer isn’t happy with the product they have paid for, there is appropriate redress.

A vital part of the consumer rights toolkit is the chargeback. For credit card customers, it provides reassurance that if goods arrive damaged, not as advertised, or if the merchant ceases trading, the customer can recoup some of the costs directly from the credit card issuer.

As ecommerce continues to grow at close to 20% per year in the EU, with total ecommerce revenues predicted to be €185.39 billion for 2015,¹ it is important that consumers can buy with confidence if this trend is to continue.

Chargebacks are undoubtedly important for consumer confidence. But, what happens when consumers abuse these rights? And what happens when the policies of card schemes incentivise chargebacks? Quite simply you get chargeback fraud, also known as friendly fraud.

Friendly fraud is the hidden problem in ecommerce, because merchants don’t often realise the extent of it and it is not typically carried out by criminal gangs, but by ordinary consumers. More and more customers are fraudulently claiming chargebacks on credit card transactions and merchants are bearing the brunt of it.

Friendly fraud has been growing 41% in recent years,² costing over €10billion in industry losses, compared to around €2billion lost through ID fraud, according to Visa.

The problem is also exacerbated by the existence of banks that offer both issuing and acquiring services. The chargeback system is, essentially, cannibalising their own profits.

Europe is ‘leading’ the way in friendly fraud activity and merchants will continue to be at risk unless they face up to the problem and act decisively. Otherwise, as ecommerce continues to boom, so will friendly fraud.

¹ Ecommerce News, February 2015
² US Digital Transactions Corporation
CURRENT SITUATION

There are three main forces currently influencing the situation in Europe:

1. Merchants unable to tackle the problem effectively
2. Consumers who wouldn't consider themselves fraudsters carrying out fraudulent activity
3. Unwillingness of card schemes to properly address the fraud

MERCHANTS UNABLE TO TACKLE THE PROBLEM EFFECTIVELY

86% of chargebacks are fraudulently placed, skipping the merchant & going straight to the chargeback process

Merchants can often be unaware that a customer has gone directly to the bank, instead of the merchant, for a refund. They have to be able to identify when a chargeback claim may be fraudulent and be able to prove it. Otherwise they lose not only the refunded value of the product but the physical product as well (if the customer claims it was not delivered), as well as receiving a fine from the bank and a potential loss to reputation.

Only 14% of cardholders contact merchants prior to charging back

28% of cardholders contact after a dispute is already filed, creating a double whammy to many merchants

58% of cardholders do not contact the merchant at all – filing the dispute directly with the bank

When merchants are unaware of chargebacks, they have less time to challenge them. Timescales vary depending on the scheme, but with some giving merchants as little as five days to challenge, collating the evidence needed to challenge effectively is daunting, especially for smaller enterprises.

The problem is getting worse. While other forms of card fraud are declining, card not present (CNP) fraud (of which chargeback fraud represents a significant proportion) is on the increase.

The most recent figures from the European Central Bank show that CNP fraud accounts for 60% of all EU card fraud and the figure has been rising steadily since 2008.  

A Federation of Small Businesses report into Cyber security and fraud shows that only 20% of merchants have risk assessment procedures in place and 17% have no cyber security measures in place at all. When merchants can’t tackle chargeback claims in a timely and effective manner, they are leaving themselves vulnerable to fraud.

CONSUMER ACTIVITIES

What makes this fraud especially concerning is that, by and large, it is not carried out by organised gangs. It is carried out by individuals who would probably never think of themselves as fraudsters or criminals. But crime is what it is, stealing money and goods from merchants.

Customers usually don’t want to take extra time to contact the merchant; they can’t find the information they need to reference for their order, or perhaps they forgot to return a product within the time frame. So they call their credit card company for a quick solution with seemingly no consequences. However, the costs of this are ultimately borne by the merchant, leading to increased prices for the consumer. Many customers also do not realise the personal risk they are taking, leaving themselves vulnerable to a processing fee if their chargeback request is declined by the bank and successfully disputed by the merchant.

Figures also show that if a customer gets away with it once, they will do it again.

40% of consumers who file a fraudulent chargeback will do it again within 60 days according to Visa

Chargebacks represent small individual amounts. In the UK, for example, the maximum a consumer can request on a chargeback, before claiming Section 75 rights, is £100. But these small amounts add up to larger amounts: €10 billion across the EU.

If a merchant suffers from a fraudulent chargeback, it is not just the money they are losing. They’ve lost the merchandise they provided, as well as time and reputation.

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3 Third Report on Card Fraud, ECB, February 2014
4 Cyber security and fraud: The impact on small business, FSB, 2013
When card schemes and banks are challenged about APRs on their credit cards, one of the first responses is that APR costs include protection for the consumer such as chargebacks. It is, of course, right that banks and card schemes protect consumers.

Yet the issuer and consumer are only one half of a four party payment scheme. Where does bank activity leave acquirers and merchants?

The Federation of Small Businesses’ report into cyber security and fraud showed that when it came to tackling this type of fraud, 45% of British SMEs wanted banks to do more. More than police (31%) and more than targeted advice (27%), British SMEs want banks to lead the way and take action.

The problem would seem to be that banks aren't carrying out enough due diligence. And they don’t do this because merchants don’t appeal enough cases. And merchants don’t appeal enough cases because they often aren’t aware of the chargeback until it is too late.

In the EU, it costs around €50 for a bank to file a chargeback. If that chargeback is successfully appealed, it costs the bank around €150. It is not financially beneficial for banks and schemes to have chargebacks challenged.

In the UK, for example, most major banks all have acquiring arms as well as being issuers. This creates a bizarre scenario where the banks carry out chargebacks, sometimes questionably, against themselves.

If there is anything that demonstrates the lack of care banks pay to chargebacks and the fact that the situation is getting out of hand, it’s this scenario. Banks are, in essence, cannibalising their own profits. It is time for them to act. It is time for change.

To maintain a good relationship between customer and merchant, the rights of both parties have to be upheld, often by the banks. In the case of chargebacks, this is not happening and it is leaving the door open to fraud.

Fraud isn’t a victimless crime. Friendly fraud is theft. It takes money and goods from merchants. This causes prices to rise for everyone and it can put companies out of business. It is time to swing the balance back to an equilibrium between merchant and customer and, if banks cannot or will not help, merchants have to take control of the situation themselves.
When it comes to fraud, it is the small enterprise who suffers most. The most recent figures from the National Fraud Office show that small enterprises in the UK are the ones getting hardest hit.

In 2013, the total value of fraud in the private sector was £5.7bn. The small business proportion of that was £4.6bn. Almost 81% of fraud against the UK private sector is against small business. Research by Experian suggests that, in their lifetime, a small business will lose £2627 to fraud. For small businesses with tight margins, this is money they cannot afford to lose.

This is not unique to the United Kingdom. It is a global pattern. Why? Because small businesses don’t have the protection that larger businesses have.

Fraud has two main types – opportunistic and planned. A small enterprise without the policies, procedures and technology in place to guard against fraud is always going to be attractive to any fraudster, whether they are an active criminal or simply a customer trying to get a ‘cheeky’ chargeback.

Friendly fraud is by and large an opportunistic fraud. So it can be managed against. What is needed is the willingness to do so.

Ultimately, it is about successfully challenging friendly fraud. Figures from Visa suggest that a mere 25% of chargebacks are successfully challenged. Here’s how to be in that 25%:

1. **EMPLOY BEST PRACTICE**

   Maintain delivery receipts. Fraudsters will claim their goods haven’t arrived. If you can prove otherwise, you can challenge.

   Clearly define your cancellation and refund policies. When customers buy something from you, they are entering into a contract. Part of that contract are their refund and return rights. Make sure these are well defined and won’t leave you open to fraud.

2. **IMPROVE YOUR CUSTOMER SERVICE**

   Only 14% of customers contact the merchant before charging back. When the merchant is unaware of the chargeback, the merchant is unprepared. So make it easier for customers to get in contact with you. Respond promptly to customer queries. Have well-publicised response targets. Monitor social media and track all customer interactions. In short, don’t give customers the excuse that they weren’t able to get in contact with you.

3. **IDENTIFY AND TACKLE THREATS EARLY**

   Only 20% of UK small businesses have a risk management plan. Fraud is risk and risk should be managed effectively. Failure to do so is carte blanche to fraudsters.

   Risk management helps you identify threats before they happen. Maintain dynamic reporting on fraud and chargebacks. Look for patterns and regular occurrences. Awareness of fraud makes it easier to tackle.

4. **BALANCE SECURITY WITH CUSTOMER EXPERIENCE**

   Security is a hygiene factor in online purchasing behaviour. Customers simply expect it. What is a motivating factor, though, is speed and ease of purchase. So be secure, but don’t let that security get in the way of a smooth and speedy customer experience.

5. **CHALLENGE WITH CONFIDENCE**

   If your enterprise can tick off one to four on this list, you can challenge with confidence. You know the goods were delivered and were sold as advertised. You know when the customer hasn’t contacted you through any of your multiple channels. Your risk reporting tells you that this has the characteristics of fraud. You know it was sold securely. So challenge that chargeback.

   Issuers file less chargebacks against those who challenge them. Don’t be a soft touch. Challenge with confidence and protect your business.

   The technology exists to do just this. There are scalable enterprise solutions which can work for issuer, acquirer and merchant alike. And they can be a critical tool in your fraud fighting armoury.

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6 2013 Annual Fraud Indicator, National Fraud Office, 2014
7 Ccrmagazine.com, 17 February, 2015
WHAT ABOUT CARD SCHEMES?

Friendly fraud is a symptom of the digital entitlement age. People expect instant gratification and results and friendly fraud is part of that trend. Whether it is a legitimate or fraudulent claim, it is seen as an easy way to get money.

Yet the elephant in the room is the seeming unwillingness of card schemes to tackle the problem.

This white paper has examined why merchants should protect themselves and how they can do it. However, unless banks and schemes act, the problem will get worse. As ecommerce continues to grow, so will opportunities for fraud.

Schemes need to act to remove the friendly fraud incentive. It suits both issuers and card holders to resolve chargebacks quickly and this makes fraud easier and more attractive.

Only the merchant pays for fraudulent claims. Perhaps if schemes were to look at penalising both issuers and cardholders for fraudulent claims, it might make some think twice before putting in the questionable claim.

Put simply, too much onus is on the merchant and not enough on the banks and schemes. Smaller businesses suffer disproportionately and today’s SME is the global powerhouse of the future. Anything that unfairly and unnecessarily impedes their growth is bad for business, innovation and the economy.

The enterprise solutions that exist can give merchants the power to successfully challenge chargebacks and the more that are challenged, the more the problem will decrease. But it will remain a problem until card schemes stop letting fraudsters challenge with impunity.