How Does The Chargeback Process Work?

By **Rafael Lourenco**, EVP at **ClearSale**

In an ideal world, credit card transactions go off without a hitch. A customer makes a purchase and gets their product or service, and the merchant gets paid. And everyone is happy.

Unfortunately, e-commerce isn't an ideal world, and not every transaction is seamless.
Sometimes, a customer disputes a transaction with a merchant, resulting in the credit card issuer reversing the payment and returning the funds to the customer.

These payment reversals, known as chargebacks, are inevitable for merchants — especially those selling online. And if they happen too often, they can lead to significant direct and indirect costs for merchants. Here's what merchants need to know about the chargeback process itself and how they can protect themselves.

Step 1: Cardholder Files a Chargeback

The chargeback process begins with a customer making a chargeback request. And while customers often file these chargebacks because fraudulent activity is being conducted on their accounts, it's not the only reason. Here are the four main sources of chargebacks:

Criminal Fraud

Criminal fraud occurs when someone uses another person's payment card information without authorization, and it's what typically comes to mind when merchants and customers think of chargebacks.

Consumer Disputes

Buyers may make honest mistakes when they dispute charges on their statements — like when they completely forgot they made a purchase. Other times, consumer disputes are deliberate attempts to defraud a merchant and get something for nothing.

Authorization Issues

When merchants fail to get the proper authorization for a transaction, don't submit a valid authorization approval, or fail to provide a verifiable authorization, authorization problems and chargebacks can result.

Processing Errors

When a consumer believes a merchant didn't hold up their end of the deal (like when a customer places an order but the merchant doesn't deliver it), it's considered a processing error.

Step 2: Credit Card Issuer Assigns a Reason Code

When a merchant is on the receiving end of a chargeback, one of the first signs that something has gone wrong in a transaction is usually when they receive a chargeback notification from the credit card issuer. Alongside this notification is a code that explains the reason the customer gave for filing the dispute. Not only do these codes give merchants a better understanding of why the chargeback was filed, but it also outlines what compelling evidence is required for a successful chargeback reversal.

Merchant Tip: By knowing individual card issuers' codes, merchants can identify which transactions have the most potential to affect revenue and which codes their business is most vulnerable to. That can help them become better prepared to prevent and defend against future chargebacks.

Step 3: Merchants Respond to the Chargeback

Once the merchant is made aware of the chargeback, it's time for them to act, making one of two choices:

- Accept the chargeback and any associated fees and penalties.
- Dispute the chargeback and prepare a response.

Before merchants make their final decision, they need to determine whether the chargeback is worth disputing.

It's true that chargebacks have significant costs that frequently exceed the cost of an unpaid product or service. But for many merchants, countering a claim may cost precious time and resources that would be better invested in other areas of their business.

But that doesn't mean merchants should never dispute a chargeback. In fact, there are situations when it's actually a smart move, like when:

- The transaction was legitimate, and disputing the chargeback could help prevent the customer from filing fraudulent claims in the future.
- You've already resolved the issue with the customer (e.g., you've refunded the disputed amount).

Merchant Tip: Just over 20% of global chargebacks are decided in the merchant's favor. So if you decide to fight a chargeback, it won't be easy.

If the merchant decides to proceed with disputing the chargeback, they'll need to comb through their business records for the compelling evidence that will prove the disputed charge is valid, such as:

- Delivery confirmation that shows the order was delivered to the customer.
- Correspondence between the customer and the merchant.
- Proof the customer knew of and accepted the merchant's service, return and refund policies.
- Screenshots of a customer's public social media account that show the disputed goods being used.

Merchants must be mindful that while customers have ample time to file chargebacks on a purchase (often up to 120 days), merchants have far less time to defend themselves. Visa now allows merchants just 30 days to respond, while PayPal offers just 10 days for a response.

And if merchants fail to submit their evidence in time, not only are merchants automatically assigned guilt, but they may also now face additional fines and penalties for not addressing the chargeback.

Step 4: The Credit Card Issuer Makes a Decision

If the credit card issuer decides in favor of the cardholder after reviewing the evidence, the cardholder gets to keep the funds. And when a merchant loses, not only are they out the cost of the lost product, but they're also out:

- Expensive chargeback fees and penalties.
- The potential loss of their merchant accounts if their chargeback ratios are too high.
- Reputational damage.

Even when merchants win chargeback disputes, they're inevitably out time, money and resources to do so. That's why it's critical for merchants to partner with a trusted fraud solution that will protect them against the expensive effects of chargebacks.

Some solutions even offer chargeback guarantees, which will protect a merchant in the event their fraud prevention provider inadvertently approves a transaction that turns out to be fraudulent and results in a chargeback. And with each chargeback potentially costing merchants $75, smart merchants are putting every possible strategy in place to protect their business.

Author:

Rafael Lourenco is Executive Vice President and Partner at ClearSale, a card-not-present fraud prevention operation that helps retailers increase sales and eliminate chargebacks before they happen. The company's proprietary technology and in-house staff of seasoned analysts provide an end-to-end outsourced fraud detection solution for online retailers to achieve industry-high approval rates while virtually eliminating false positives. Follow on twitter at @ClearSaleUS or visit www.clear.sale.