



# The Real Costs of Dispute Processing

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## Abstract

When one surfs the net for information on credit card disputes, one will usually find articles referring to credit card fraud committed both by merchants and consumers, but credit card disputes are not always related to unauthorized transactions. In fact, according to estimates, credit card fraud makes up around 60% of the total volume of credit card disputes.

Nonetheless, a greater surge in disputes can be attributed to poor service, defective products and missed expectations. Nearly 8 out of 10<sup>1</sup> consumers prefer to file a dispute instead of settling the issue with the merchant directly. In all, approximately \$40 billion USD in annual disputes, including fraud related disputes, first need to be captured by a bank system. Data needs to be gathered and someone needs to determine what the next step should be – deny the dispute, issue a refund, or raise a chargeback. The dispute process can take anywhere from **50 to 160 minutes**. This process repeats itself every single business day in virtually every bank in the world. McKinsey estimated that the cost dispute process of the top 15 U.S. banks reaches about \$3 billion annually<sup>2</sup>.

In most cases, the dispute resolution process is not standardized at the branch and or the bank level. Additional confusion is caused because bank dispute departments are not typically updated on a timely basis about changing network rules and governmental regulations and the cost of consistent re-training can cost millions of dollars annually Even

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<sup>1</sup> <https://www.chargebackexpertz.com/11-frightening-chargeback-statistics/>

<sup>2</sup> <https://www.mckinsey.com/industries/financial-services/our-insights/payment-disputes-in-banking-a-pathway-to-deeper-customer-relationships>

though banks strive to be compliant, the sheer amount of manual paperwork required to process a dispute often makes this difficult to impossible. This paper will examine the



total cost of handling disputes from an operational perspective – the **real** cost that banks must absorb every day.

## Background

All credit card network operators require that their issuing banks handle disputes. The process, however, is complicated. For example, the Visa Core Rules handbook (1,031 pages long!), as well as a code of conduct, must be followed by the issuing and acquiring banks, as well as merchants. Sections 1.11.1 and 11 delineate the dispute rules. These include the following:

*“An Issuer must resolve Cardholder disputes under the Visa Rules by extending to Cardholders all protections provided on any Visa Card under applicable laws or regulations and by utilizing the Issuer’s customary practices to resolve Cardholder disputes, regardless of which type of Visa Card was used. Thus, the resolution of such Cardholder disputes will be the same in similar circumstances regardless of which type of*

*Visa Card was used. The foregoing applies only with respect to Transactions on Cards using the Visa Brand Mark”<sup>3</sup>*

Mastercard, American Express, Discover and other card networks impose similar obligations on the issuing bank, acquiring banks and merchants.

## The Dispute Quandary

There are no standards for handling a credit card dispute, just guidelines. That applies to onboarding, investigating and the actual processing of the dispute itself. Some banks allow dispute claims to be filed online, while many others require customers to fill out forms and fax or mail them in. In certain cases, larger banks might employ different methods of dispute processing across regions.

Whatever the method they employ, most banks view dispute resolution as a necessary evil, since issuing credit cards is a big business. Card banks saw their net interest income – the interest they earn minus the cost of funds – rise to 8.73 percent of assets in 2015.<sup>4</sup> Interestingly, their income from fees and other non-interest sources fell 1.9 percent, following an additional 1.5 percent decline in 2014. Why is non-interest income falling?

The trend dovetails with the growing practice of **waiving fees** – mainly annual card fees – which is intended to keep customers from switching cards. **Banks have realized that keeping the plastic in the customer’s hands is a must. The cost of acquiring a new customer is high and once a customer is lost, there are endless other options for securing a new card. Customer satisfaction** is a topic we will consider below, but it is certainly an important factor to consider when thinking about creating a positive dispute processing experience for customers.

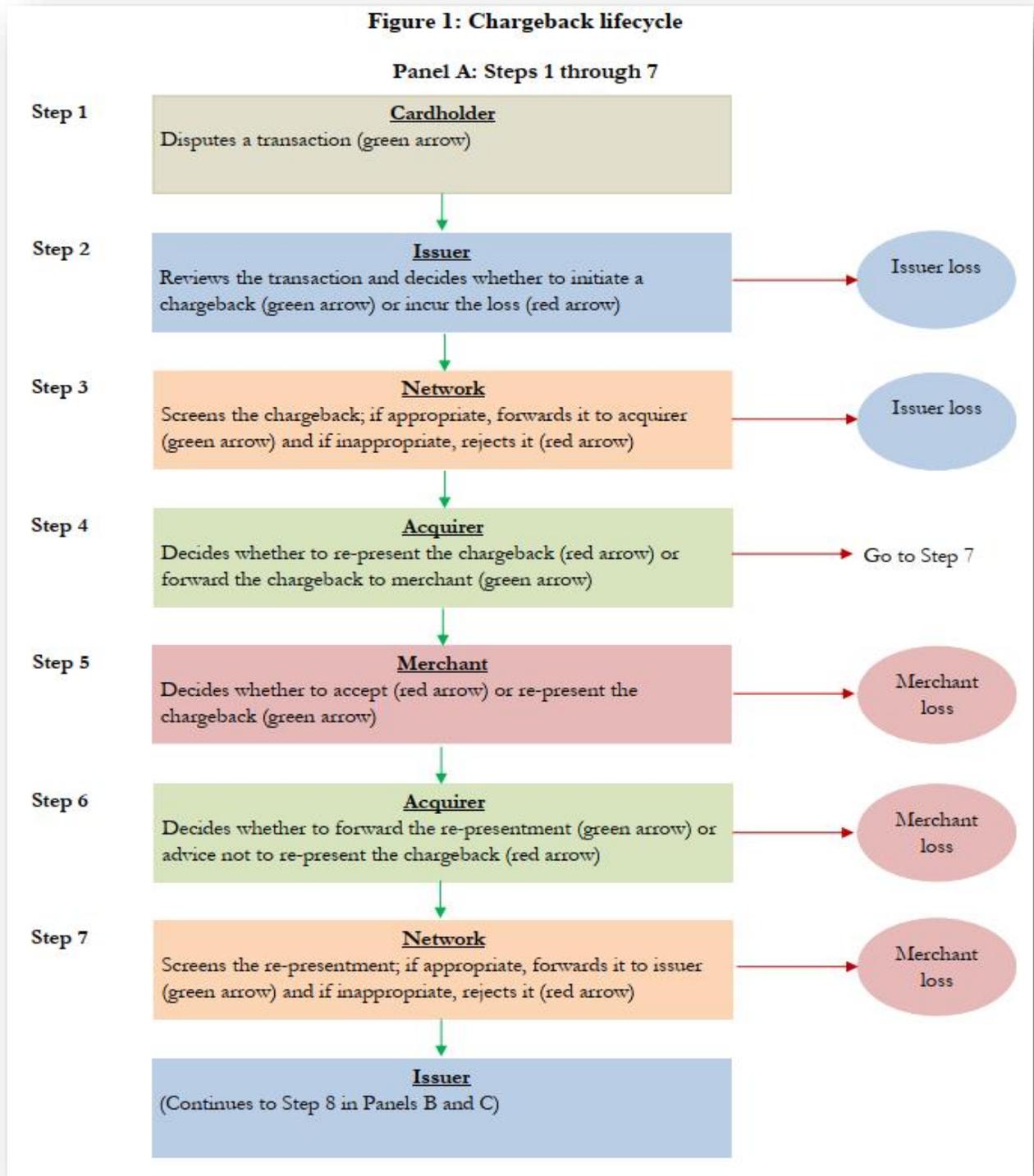
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<sup>3</sup> <https://usa.visa.com/dam/VCOM/download/about-visa/visa-rules-public.pdf> - page 641

<sup>4</sup> <https://www.creditcards.com/credit-card-news/card-issuer-bank-profit.php>

A second important factor to consider is that dispute processing is generally carried out with few **technological enhancements**. By this we mean, that yes, technology is being used, but not in a consistent end-to-end fashion. Technology is not necessarily being used to connect all the necessary data points or even to assist in routine tasks. Technology should be used as part of a 360 approach, encompassing all data and tools needed to make a well-informed analytic decision that, at the same time, lends itself to a positive customer experience.

The general process for handling a dispute is as follows:<sup>5</sup>



<sup>5</sup> Federal Reserve Bank of Kansas City <https://www.kansascityfed.org/~//media/files/publicat/reswkpap/pdf/rwp16-01.pdf>

As one can see, the dispute process can be long and complex. Let's drill down on Steps 1 and 2 with the goal of determining how much time and effort is spent in completing a typical dispute.

### Step 1: Dispute Onboarding

**Time spent by the bank is about 20-40 minutes**

#### Facts

- In most cases, the request to open a dispute needs to be filed within 120 days of the transaction
- Verification of a transaction is largely done manually
- A bank dispute department is divided into two teams, one for cases of fraud and the other for all other types of disputes
- Non-fraud disputes do not always result in accounts being credited

#### Process

- Customer: I have a dispute
- Bank: The transaction to be disputed has to be located
  - The customer's identity has to be verified
  - The transaction date has to be documented
  - The merchant has to be identified
- Customer: Lists one or more transactions
- Bank: What happened?
  - Fraud: Do you have your card?
    - Yes:
      - ✓ Cancel card
      - ✓ Issue credit
      - ✓ Issue new card

- No: When was the last time you had your card?
  - ✓ Cancel card
  - ✓ Issue credit
  - ✓ Issue new card
- A background check verifies that no PIN was used. If one was used, the dispute is declined.
- Non-fraud:
  - Bank: What happened?
  - Customer: Describes what happened (bank enters notes into its system)

#### Step 2: Back Office Processing

**Time spent by the bank is about 30-120 minutes**

#### **Facts**

- Back office receives cases about 24-48 hours after disputes have been captured
- There is probably some methodology for how disputes are processed (value of customer, amount of dispute, etc.)

#### **Process**

- Dispute team reviews information and decides either:
  - Additional information is required
  - The dispute is denied – a letter is generated and sent to cardholder concluding the process
  - A dispute is raised with credit card network (Visa/Mastercard)

The initial steps in the dispute process can take anywhere from 50 to 160 minutes before

a chargeback has been raised (which occurs only about 0.016% of the time)<sup>6</sup>.

Now let's look at how chargebacks are handled.

### Step 3: Opening a Dispute with the Credit Card Network

**Time spent by the bank is about 15 minutes**

#### **Facts**

- The issuing bank will determine the proper dispute code
- Credit card network dispute systems require manual entry of the dispute details as well as supporting documentation

#### **Process**

- If the dispute team decides to raise a dispute (i.e., a chargeback), the information is entered directly onto a credit card network system
- The entry process is determined by the dispute code
- The merchant is then informed via the payment processor and/or the acquiring bank

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<sup>6</sup> <https://www.kansascityfed.org/~media/files/publicat/reswkpap/pdf/rwp16-01.pdf>

## Step 4: Merchant's Response

**Time spent by the bank is about 10-120 minutes**

### **Facts**

- Visa gives the merchant 30 days to respond
- Mastercard gives the merchant 45 days to respond
- This step affects the merchant's chargeback ratio, whether the merchant wins or not. As of October 2018, Mastercard allows the merchant to issue a refund without affecting his chargeback ratio.
- If the dispute goes to arbitration, a significant fee is paid by the loser per each transaction. The process is determined by the credit card network without any verbal input by the issuer or acquirer.
- Today, disputes take an average of 46 days to resolve, though contentious disputes may take more than 100 days

### **Process**

- The dispute team at acquiring bank/payment processor reaches out to the merchant
- The merchant receives a write-up of the dispute as well as accompanying documentation
- The merchant's response is added manually to the credit card network system
- Subsequent steps depend on the credit card used by the cardholder (see table)



## The Costs Associated with Dispute Processing

Once we understand the complexity and the time required for handling a dispute, we need to consider the costs in doing so.

The most common way to calculate the costs of a dispute is by looking at the direct costs of handling them. According to McKinsey<sup>7</sup>, the top 15 U.S. banks spend about \$3 billion annually on dispute processing. Using this estimate (\$10 to \$50 per dispute) we can come up with a global estimate of anywhere from \$5.2 billion to \$26 billion (based on about 260 million disputes annually). Bear in mind that these costs do not include the cost of raising a chargeback and the value of the dispute.

The problem with direct costs is that they **hide** the other costs involved in handling disputes. In a way, direct costs are the proverbial tip of the iceberg. What is much more

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<sup>7</sup> <https://www.mckinsey.com/industries/financial-services/our-insights/payment-disputes-in-banking-a-pathway-to-deeper-customer-relationships>

difficult to assess is the opportunity costs – such as the cost associated with a complex operating model, the cost of over-processing disputes or the cost resulting from inconsistencies across organizations.

Part of the problem is that most banks are not using proper metrics in processing disputes. Banks are more focused on regulatory issues than performance and customer satisfaction. For example, a simple rule-based approach might not consider customers who are heavy credit card users or have a high net worth. Should those customers not be treated in the way they expect, they may take their business elsewhere. Additionally, small disputes might be over-processed, so that the money spent on resolving them may exceed the amount of the transactions themselves.

## **The Customer Satisfaction Question**

Recognizing that issuing and acquiring banks will agree that dispute processing is a necessary evil – one that the credit card networks require from both sides – the question that begs to be asked is if there is any consumer value in handling dispute resolutions.

If we look at the fees that are waived, we will notice something quite interesting: Credit card companies are generous on late-fee waivers. This generosity is not due to benevolence, but rather good business sense. “Consumers just don’t realize how much card companies want to keep them,” noted Bill McCracken, president of Synergistics Research Corp., a market research firm that studies the credit card industry. “Issuers know that if you’re worked up enough to call, wait on hold and talk to a customer representative, then there’s a risk that you’re going to close the card,” he continued. “It’s a lot more expensive to acquire a customer these days than it is to retain one, so they do what they can to keep you.”<sup>8</sup>

Our question is even more pertinent now that we understand how difficult it is to acquire a customer and how much that customer is worth to the bank. It seems that banks do

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<sup>8</sup> <https://www.creditcards.com/credit-card-news/lower-rate-fee-waiver-poll.php>

not realize the value that streamlining the dispute process can mean for customer satisfaction. Banks ought to treat the dispute process like any other customer touchpoint and do what they need to do to retain the customer.

## **Summary**

Dispute processing costs banks serious money, ranging anywhere from \$5 to \$26 billion annually. These are the costs that easily can be assessed. Other less tangible costs, those resulting from over-processing and the loss of customers due to poor service make the total cost significantly higher.

Banks, therefore, need to utilize better processes that feature streamlined and well-integrated systems with advanced analytics and machine learning. This will cut costs and yield a better, consistent customer experience.

Finscend is revolutionizing the way disputes are processed by creating a solution that will do exactly that. The Finscend Bank Dispute Platform will reduce a bank's operating expenses by an estimated 15 to 25 percent annually. This will be accomplished by the creation of a seamless, end-to-end system that begins with customer onboarding and extends all the way until chargeback processing. Moreover, it places all relevant information onto one clear dashboard that allows bank personnel to quickly process disputes and their managers to monitor workloads and analyze data. Additionally, the Finscend system provides an AI-generated score that indicates what the best outcome would be for any dispute. Apart from slashing operating costs, the combination of these three critical tools in one single platform will dramatically expedite dispute processing, ensure compliance and increase customer satisfaction.

## Links

- <https://www.consumerreports.org/consumerist/bank-employee-explains-why-it-takes-so-dang-long-to-process-debit-card-fraud-claims-disputes-and-other-fun-stuff/>
- <https://www.cesisolutions.org/2015/07/credit-card-dispute-what-happens-after-you-dispute-a-charge/>
- <https://www.mckinsey.com/industries/financial-services/our-insights/payment-disputes-in-banking-a-pathway-to-deeper-customer-relationships>
- Visa Core Rules: <https://usa.visa.com/dam/VCOM/download/about-visa/visa-rules-public.pdf>

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