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When Customers Become Fraudsters: The Hidden Cost of First-Party Fraud

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Summary and Key Findings

First-party fraud, when consumers falsely dispute transactions they know they authorized, has become a growing concern in the payments ecosystem. Financial institutions and merchants expend considerable resources to process these dispute claims and often assume financial liability for wrongly disputed transactions. This report examines the scale of first-party fraud in credit and debit card payments, analyzes the current efforts deployed by FIs and merchants to mitigate it, and provides insights into how firms can begin to solve this conundrum. The key findings from this report follow:

- **Volume is on the rise globally:** First-party fraud volume is projected to reach 30.6 million cases in 2025 and grow to 38.2 million by 2028, with estimated losses increasing from US$3.9 billion to US$4.8 billion during this period.
- **Consumers openly acknowledge disputing authorized transactions:** Between 10% to 16% of consumers admit to filing disputes for transactions they made, with motivations split evenly between wanting to avoid payment and facing economic hardship. Contrary to common assumptions, the behavior is not limited to younger demographics.
- **FIs are burdened by this form of fraud:** First-party fraud represents 14% of all chargebacks initiated by FIs, with 35% of FIs reporting increases from 2023 to 2024. This increased operational costs and the need for enhanced detection solutions.
- **Merchants are more negatively impacted by first-party fraud than FIs:** Merchants face an even higher impact, with first-party fraud accounting for 21% of their chargebacks and two-thirds reporting year-over-year increases.
- **Card network solutions are emerging:** While solutions such as Visa's Compelling Evidence 3.0 (CE3.0) and Mastercard's First Party Trust show promise, adoption remains relatively low among FIs but higher with merchants. Merchants currently using CE3.0 report high satisfaction rates, with 93% finding it effective or very effective at avoiding financial liability.
- **More industry effort is needed to mitigate chargebacks:** Despite the availability of solutions, there remains a significant need for improved fraud detection systems, enhanced chargeback processing automation, and better customer communication to prevent disputes before they occur.

Introduction

Cardholder disputes are an important element of the credit and debit card ecosystem. The disputes system is designed to protect consumers against unauthorized transactions such as fraudulent activity and disagreements between cardholders and merchants, such as items not as described, items not received, and quality and defect issues. These protections are provided by the card networks and, in some countries, via regulations such as Regulations E and Z in the U.S. However, these protections are often abused by consumers who falsely dispute transactions they authorized and performed. This abuse of the dispute system has many names, such as first-party fraud, friendly fraud, and dispute misuse. Regardless of what it is called, this growing problem adversely impacts FIs and merchants that expend considerable resources to process these dispute claims and assume financial liability for the wrongly disputed transaction amount. Datos Insights estimates that first-party fraud losses will total nearly US$5 billion over the next three years.

While first-party fraud occurs across many aspects of financial services, this report examines its scale within the area of credit and debit card payments. By understanding the scope of this issue and strategies to cope with it, industry participants can implement solutions and processes to better detect and protect themselves from this increasingly common form of fraud. The report explores the size of first-party fraud, its cost, and associated trends. It analyzes the current efforts deployed by FIs and merchants to mitigate it and provides insights into how firms can begin to solve this problem.

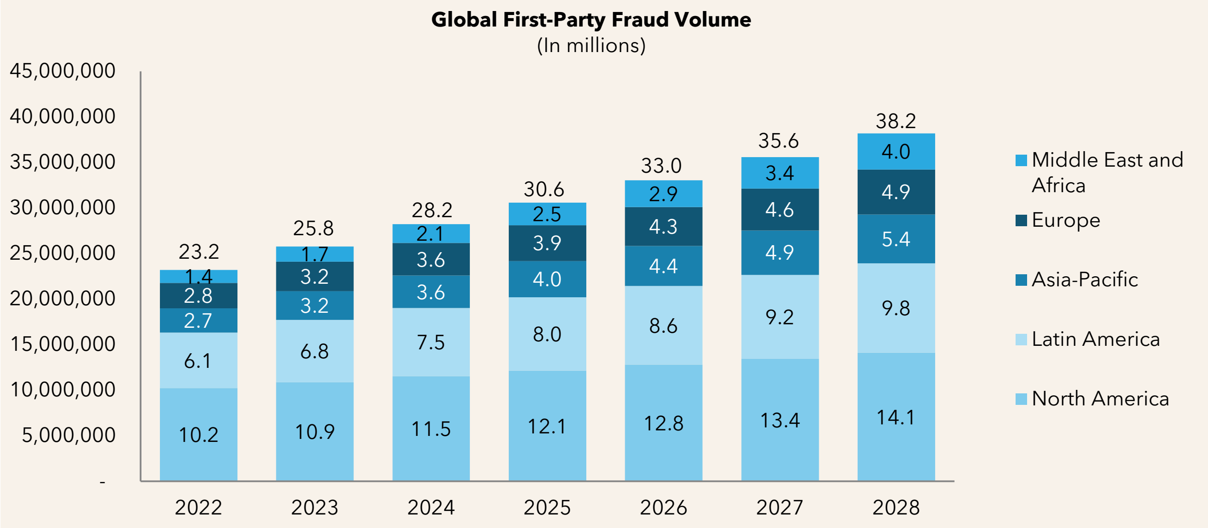
Methodology

The research for this report is based on qualitative and quantitative interviews with FIs, merchants, and consumers across multiple countries in 2024. In addition, Datos Insights interviewed card issuing and acquiring processors with significant global card transaction volume.

Market Dynamics of First-Party Fraud

First-party fraud has existed for over 20 years; two inflection points over that time span have propelled its growth. The first inflection point was the growth of e-commerce. As consumers more frequently disputed an e-commerce purchase for nonfraud reasons (e.g., item not as described, item not received, defective item), they discovered that it is relatively easy to dispute a transaction for a fraud-related reason and avoid financial liability. The other inflection point was the COVID-19 pandemic, during which cardholder disputes ballooned due to canceled trips (e.g., airline reservations, car rentals, and lodging). With the new-found time people had available during the pandemic, social media posts on how to initiate a dispute with a card issuer proliferated. As a result, first-party fraud increased. Datos Insights estimates that first-party fraud volume will reach 30.6 million incidents in 2025, growing to 38.2 million in 2028 (Figure 1).

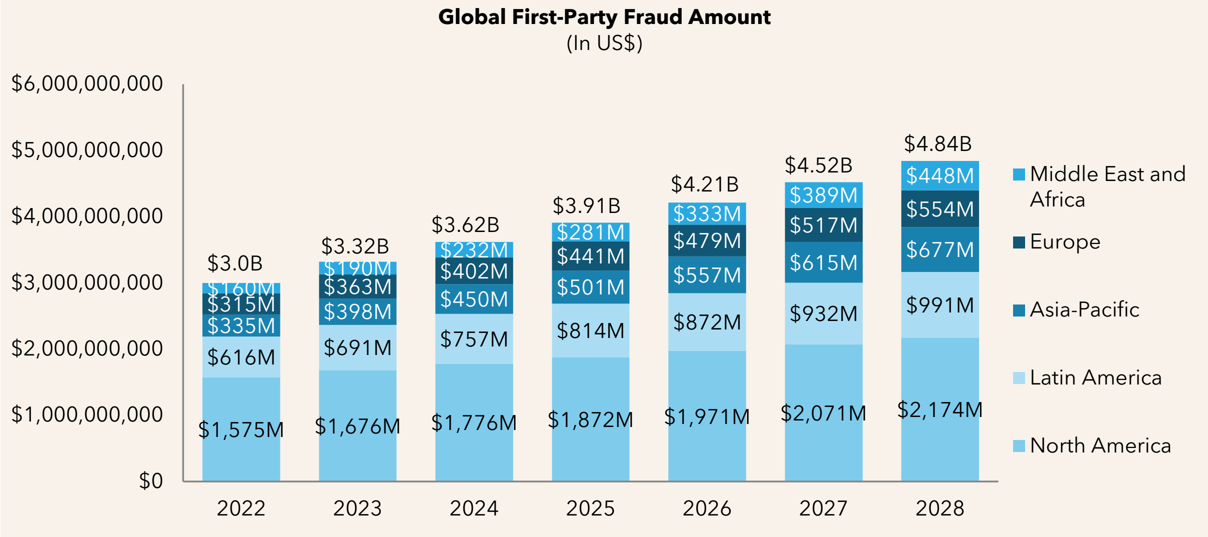
Figure 1: Global First-Party Fraud Volume Estimates



Source: Datos Insights

The card brands assign financial liability to merchants for fraudulent card-not-present (CNP) transactions and to FIs for fraudulent card-present (CP) transactions. In most first-party fraud scenarios, the disputed transaction is an e-commerce purchase. Therefore, merchants bear a large burden of the financial liability of first-party fraud chargebacks. Datos Insights estimates first-party fraud losses at US$3.9 billion in 2025, growing to US$4.8 billion in 2028 (Figure 2). The economic impact of first-party fraud is not limited to just the disputed transaction amount. FIs and merchants incur additional costs, such as staffing needed to manage cardholder disputes and chargebacks, card network chargeback fees, and issuing/acquiring processor fees.

Figure 2: Global First-Party Fraud Monetary Estimates



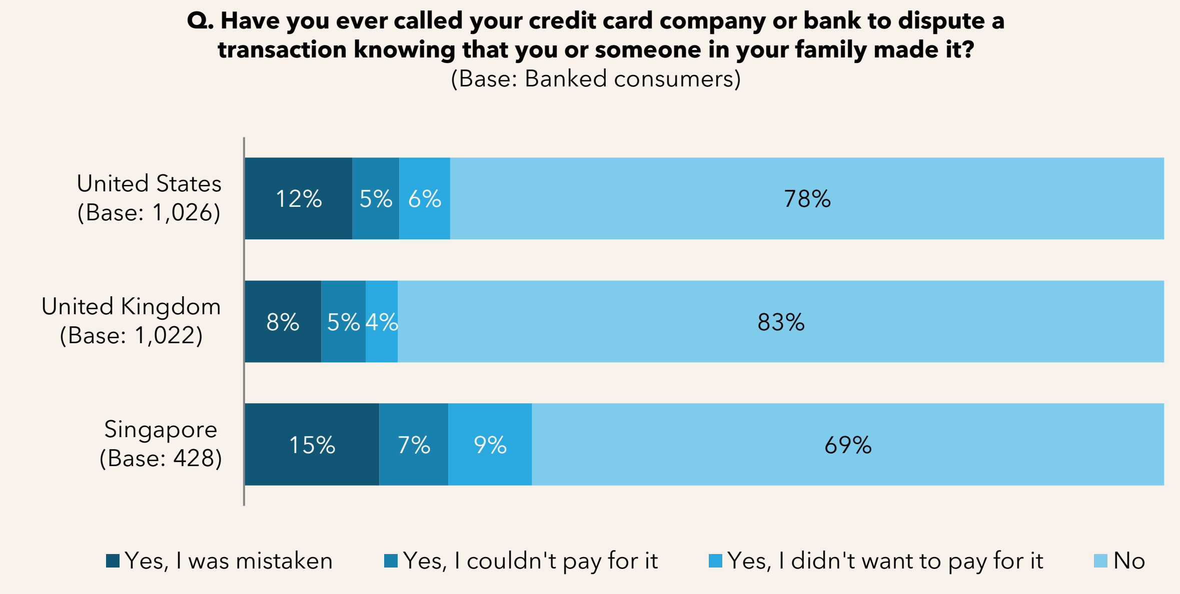
Source: Datos Insights; M=millions, B=billions

The Consumer Perspective of First-Party Fraud

Consumers acknowledge committing first-party fraud. In a Datos Insights survey of over 2,200 individuals, roughly 10% of consumers in the U.K. and U.S. and 16% of consumers in Singapore report filing a dispute on a transaction they made (Figure 3).[1] The actual number of consumers exhibiting this poor behavior is likely higher considering those consumers who may not have truthfully answered this question. There are two main reasons why a consumer may file a dispute on a transaction they perform: 1) wanting to avoid financial liability or 2) economic hardship and cannot pay for the purchase. Consumers' motivations are evenly split between these two reasons.

1 See Datos Insights' report, E-Commerce Authentication: Consumers Balance Security and Convenience, November 2024.

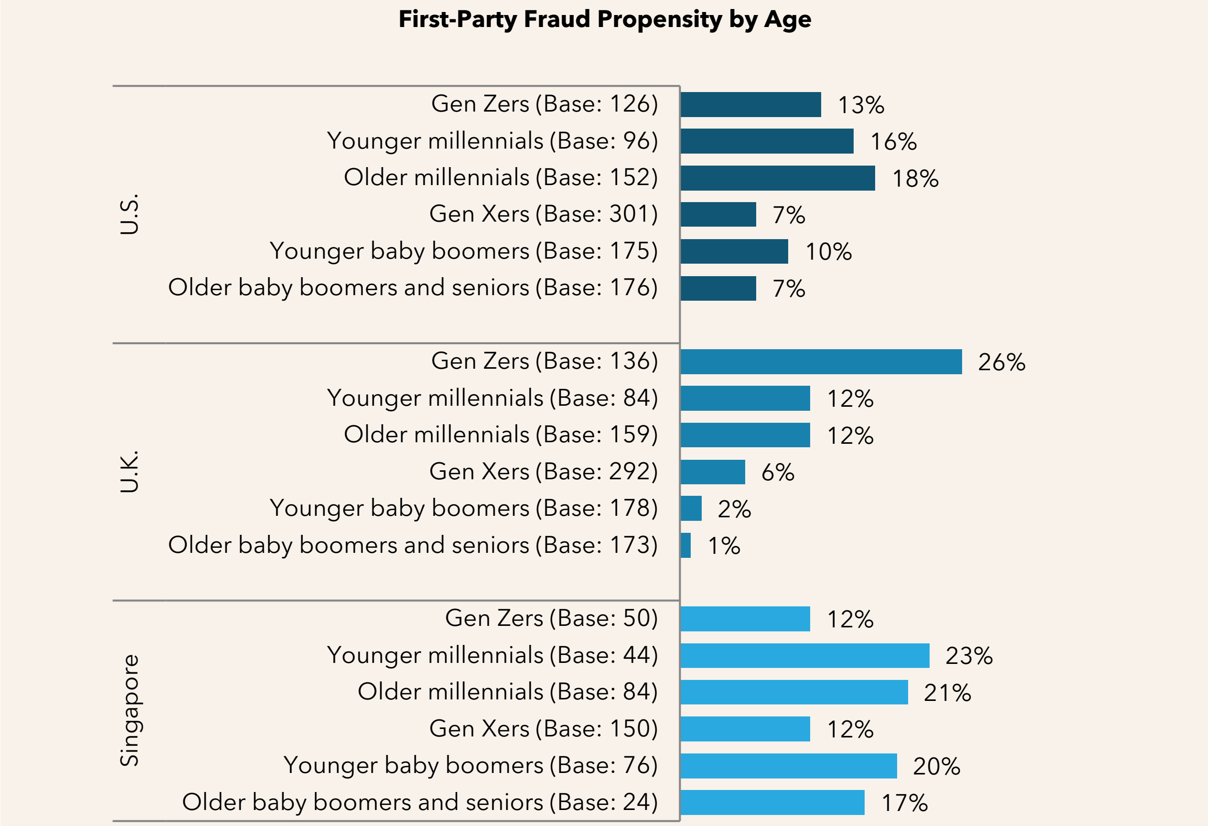
Figure 3: Percentage of Consumers Initiating a First-Party Fraud Claim



Source: Datos Insights fraud and authentication survey of 2,276 consumers, Q2 2024

First-party fraud was thought to be more prevalent among younger demographics, who are more technologically savvy and active on social media. However, the Datos Insights' consumer survey debunks that myth (Figure 4). Regardless of the country, Gen Zers and young millennials are more likely to initiate a dispute because they could not afford to pay for the transaction, while younger baby boomers, older baby boomers, and seniors are more likely to initiate a dispute because they did not want to pay for it. In the U.S. and U.K., first-party dispute filings are more common among younger generations, while in Singapore, they are more evenly spread across all age ranges.

Figure 4: Propensity to File a First-Party Dispute by Country and Age



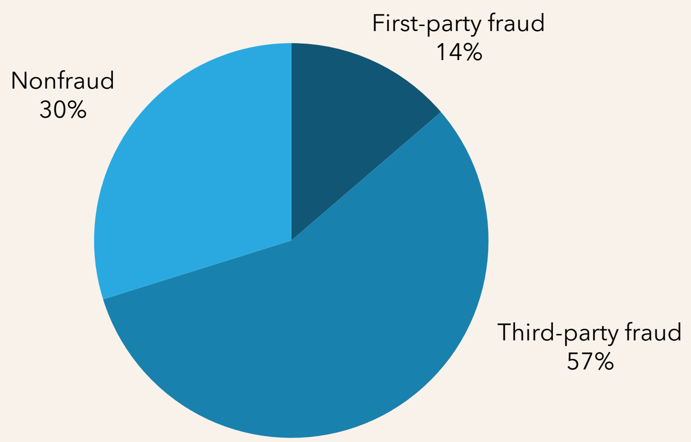
Source: Datos Insights fraud and authentication survey of 2,276 consumers, Q2 2024

FI Perspectives on First-Party Fraud

The scale of first-party fraud and the impact it has on FIs was best summarized by a chargeback executive who said, “We are paying for a lot of customers’ vacations and Christmases.” His comment speaks to the increased expenses his institution incurs due to cardholders engaging in this unscrupulous behavior. FIs report that 70% of their chargebacks are due to a fraud-related reason, with first-party fraud representing 14% of all chargebacks an FI initiates (Figure 5). Thirty-five percent of FIs report increases in first-party fraud from 2023 to 2024, with 26% reporting increases of 10% or more (Figure 6).

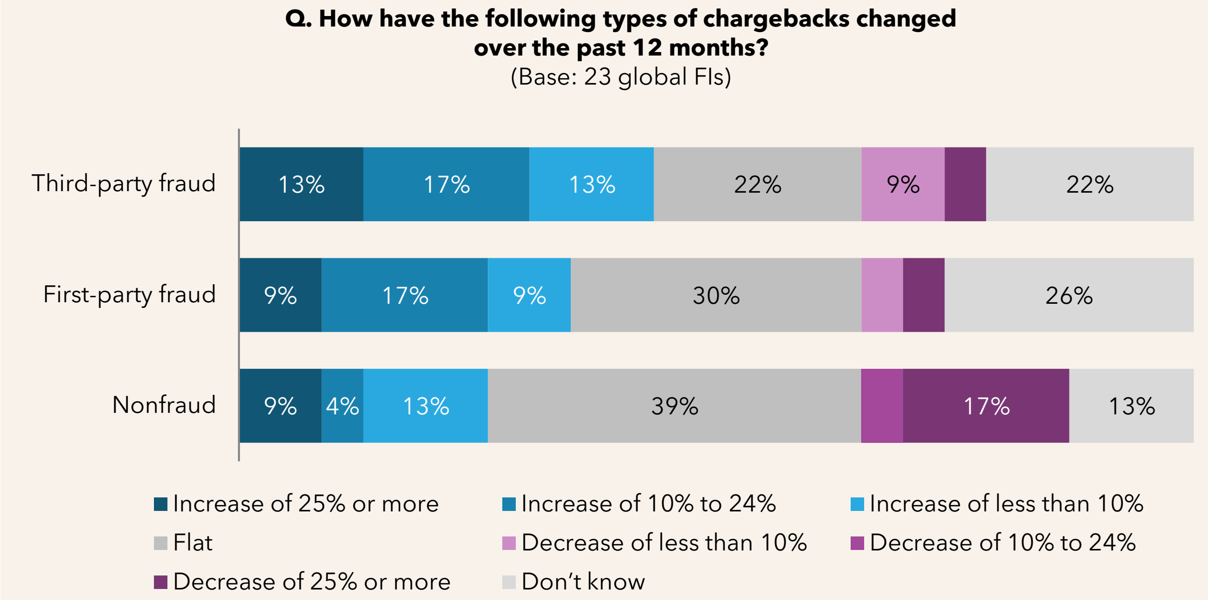
Figure 5: Percentage Share of FI Chargebacks by Type

Q. What percentage of your chargebacks are of the following types?
(Base: 18 global FIs)



Source: Datos Insights survey of 23 FIs on chargebacks in the U.S., U.K., Australia, and Brazil, Q4 2024

Figure 6: Year-Over-Year Changes in FI Chargebacks by Type

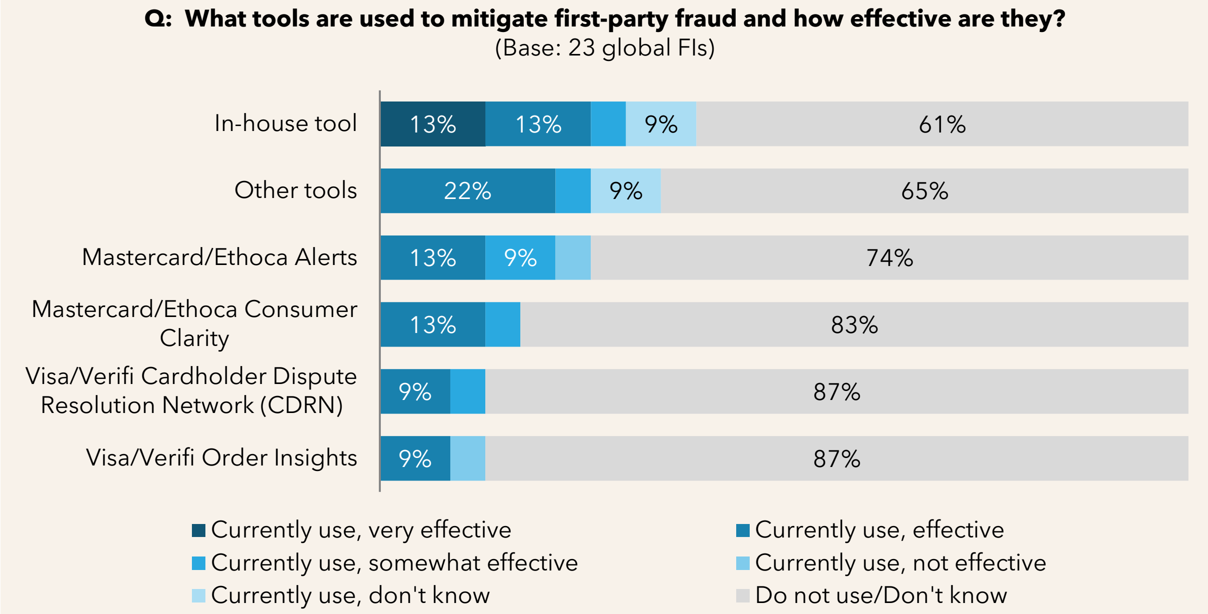


Source: Datos Insights survey of 23 FIs on chargebacks in the U.S., U.K., Australia, and Brazil, Q4 2024

Growing First-Party Technology Investments

The scale of first-party technology investments coupled with annual growth rates is a cause of increasing concern for FIs. These fraudulent disputes require increased staff and time to process them. Most chargeback departments are part of an operations group, which is commonly measured by their expense management. The ability to mitigate first-party fraud is directly related to making the operations group more cost-efficient. As such, some FIs are investing in solutions to detect and prevent first-party fraudulent disputes. More than 30% of FIs have deployed some type of solution, with in-house developed tools being the most common (Figure 7).

Figure 7: Solutions Used by FIs to Mitigate First-Party Fraud



Source:Datos Insights survey of 23 FIs on chargebacks in the U.S., U.K., Australia, and Brazil, Q4 2024

These are some examples of in-house first-party detection and preventative tools and strategies:

- **Guided workflows:** These are used by staff who take inbound claims from cardholders that include enhanced merchant descriptors. Guided workflows help to ensure the appropriate steps and activities are completed, and the appropriate information is collected to prevent, deter, and detect improper disputes.

- **Compliance-approved denial checklist:** This contains information such as spending patterns, cardholder behavior, and whether the cardholder benefited from the transaction. It is a series of questions to guide the discussion with the cardholder.

- **Chatbots that interface with cardholders:** Chatbots process low-cost or low-dollar transactions and simulate a human. Humans handle the remaining chargebacks since they are higher-dollar transactions or card-present transactions.

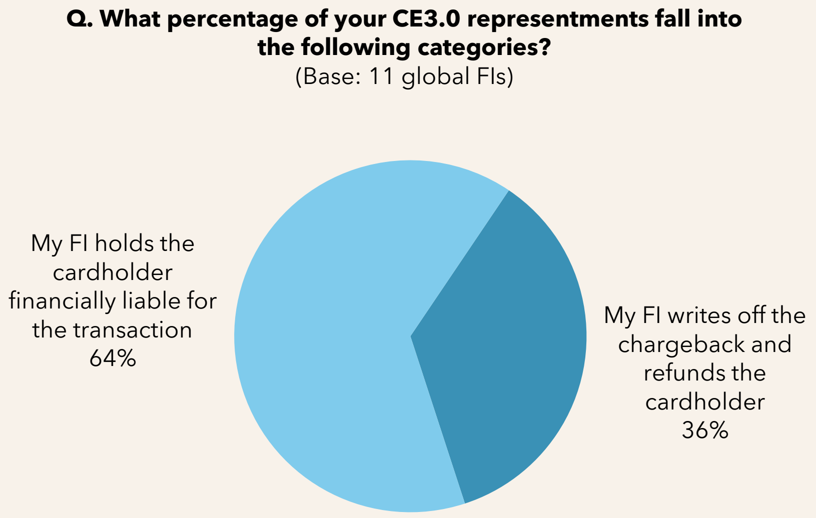
- **Weekly calls among fraud and disputes teams:** The chargebacks team conducts analysis to identify those disputes that are not fraud, and they research new trends. In these weekly calls, they identify ways to stop fraudulent disputes at the point of authorization.

Card Brands Bring Solutions to Market

The card brands have introduced specialized programs to address first-party fraud. By providing a structured way to present evidence that a transaction was valid, they create a way for merchants to fight back. Twenty-six percent of FIs use a solution offered by Mastercard/ Ethoca, and 13% use a solution from Visa/Verifi. The majority of these FIs report that the tools are effective or somewhat effective. While solutions from Ethoca and Verifi are being used to mitigate first-party fraud, their strength is their ability to prevent a dispute from becoming a chargeback. Adoption and satisfaction rates of these tools are higher among FIs when used to avoid disputes compared to preventing first-party fraud.

Visa introduced Compelling Evidence 3.0 (CE3.0) globally in April 2023, and Mastercard introduced First Party Trust in the U.S. in October 2024, though it has plans to expand geographically in the future. If a merchant believes an incoming chargeback is due to first-party fraud and the disputed transaction meets certain criteria as defined by Visa and Mastercard, the merchant can invoke CE3.0 or First Party Trust and send the required supporting data to the FI to prove it. The financial liability for the transaction shifts from the merchant to the FI. However, the intent is not to saddle the FI with the liability of the chargeback. Rather, it is to arm the FI with data to have a conversation with the cardholder, demonstrating that the cardholder performed the transaction. Most FIs will evaluate its relationship with the cardholder to determine whether to avoid a customer satisfaction issue and thus write it off, or to engage the cardholder with the data and deny the dispute. Two-thirds of FIs reject the dispute and hold the cardholder liable for the transaction (Figure 8).

Figure 8: Actions FIs Take With Compelling Evidence Data From Merchants



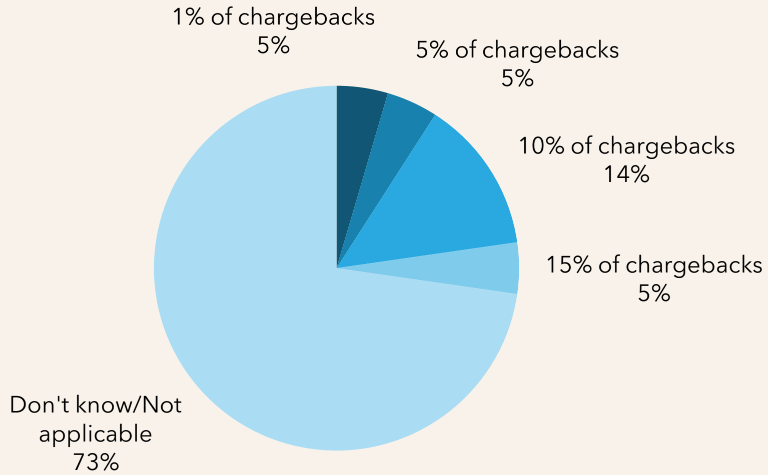
Source: Datos Insights Survey of 23 FIs on Chargebacks in the U.S., U.K., Australia, and Brazil, Q4 2024

Merchant Adoption

While FIs are required to support CE3.0 and First Party Trust, merchant adoption is optional. As with similar industry programs, merchant adoption tends to be low initially and gradually increases over time. This is borne out among FIs that see low CE3.0 volume-to-date, are not tracking it currently, or are primarily a Mastercard issuer (Figure 9). First Party Trust went live in the U.S. at the time FIs were surveyed; hence, it was too new to have data on it.

Figure 9: CE3.0 Volume Seen by FIs

Q. How many chargebacks are represented by merchants via Visa Compelling Evidence 3.0 program (CE3.0)?
(Base: 23 global FIs)

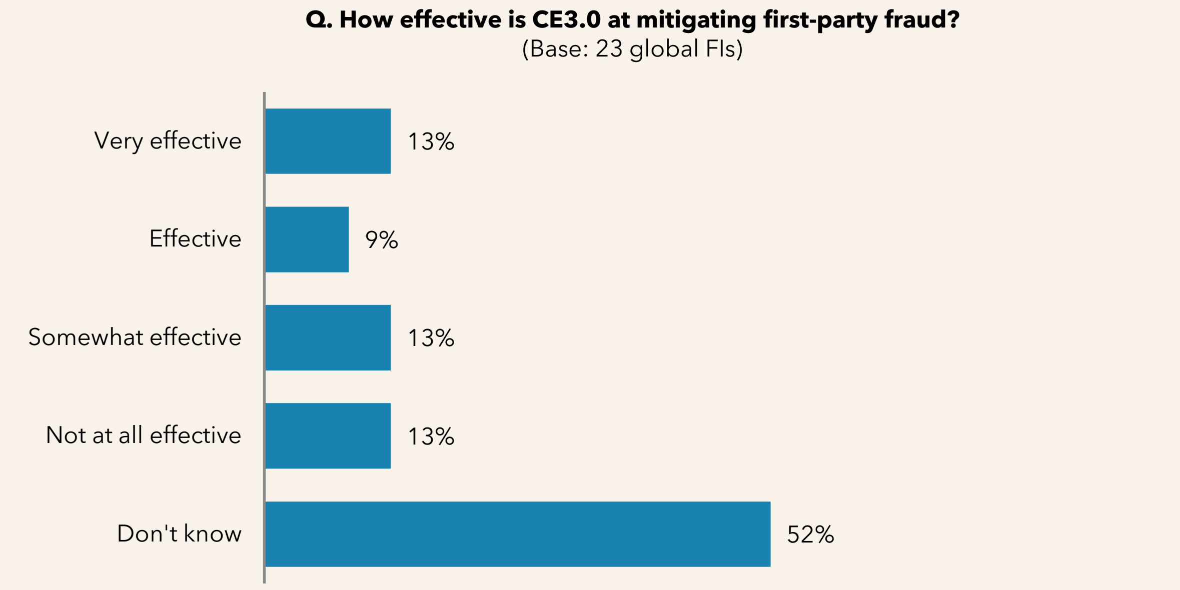


Source: Datos Insights Survey of 23 FIs on Chargebacks in the U.S., U.K., Australia, and Brazil, Q4 2024

Perceived Effectiveness

Chargeback executives have mixed opinions on CE3.0's effectiveness (Figure 10). These reactions can be attributed to the newness of CE3.0 and slower merchant adoption. Some FIs expressed concern about the lack of data quality checks on the merchant-provided data in the CE3.0 representment. On one hand, this can be rectified by the card networks by ensuring the merchant meets the requirements to file a CE3.0 representment. On the other hand, FIs have a tremendous opportunity to gain more faith in the merchant data and hold the cardholder liable for the dispute. Some of the data elements a merchant can provide include the customer's IP address, email address, and device identifier. The FI should be collecting the same data from the customer's mobile banking sessions. A data match between what the merchant provided and what the FI has via mobile banking can increase confidence in the CE3.0 data and empower FIs to hold more customers liable.

Figure 10: FI Opinions of CE3.0's Effectiveness

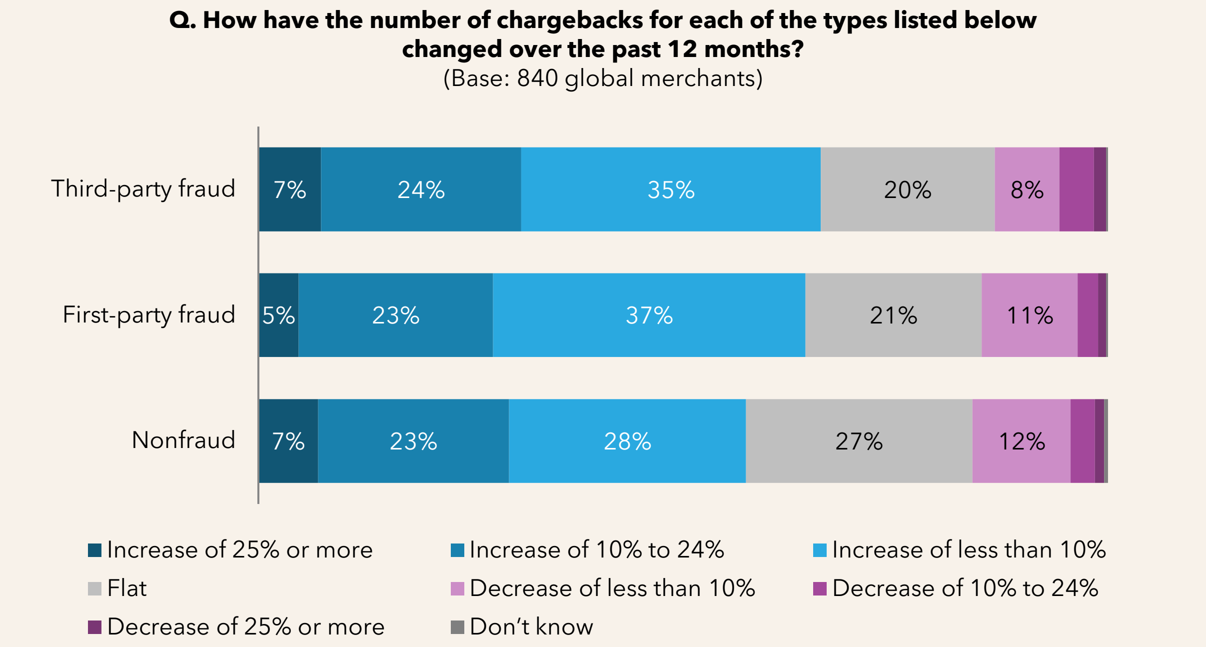


Source: Datos Insights Survey of 23 FIs on Chargebacks in the U.S., U.K., Australia, and Brazil, Q4 2024

Merchant Perspectives on First-Party Fraud

First-party fraud represents 21% of merchants' chargebacks. Two-thirds of merchants report it increased year over year from 2023 to 2024, with 28% of merchants experiencing growth rates of 10% or more (Figure 11). The share of chargebacks and annual increases due to first-party fraud are higher than what FIs report. However, merchants have more information to detect this type of fraud than FIs due to digital data insights about the consumer available during the e-commerce purchasing process. This data includes device, address (IP and email), ship-to, payment credentials, and others across multiple online purchases. Datos Insights believes the merchant-reported percentage of first-party fraud is more aligned with the actual volume in the industry than the FI-reported percentage.

Figure 11: Merchant Growth Rates by Chargeback Type

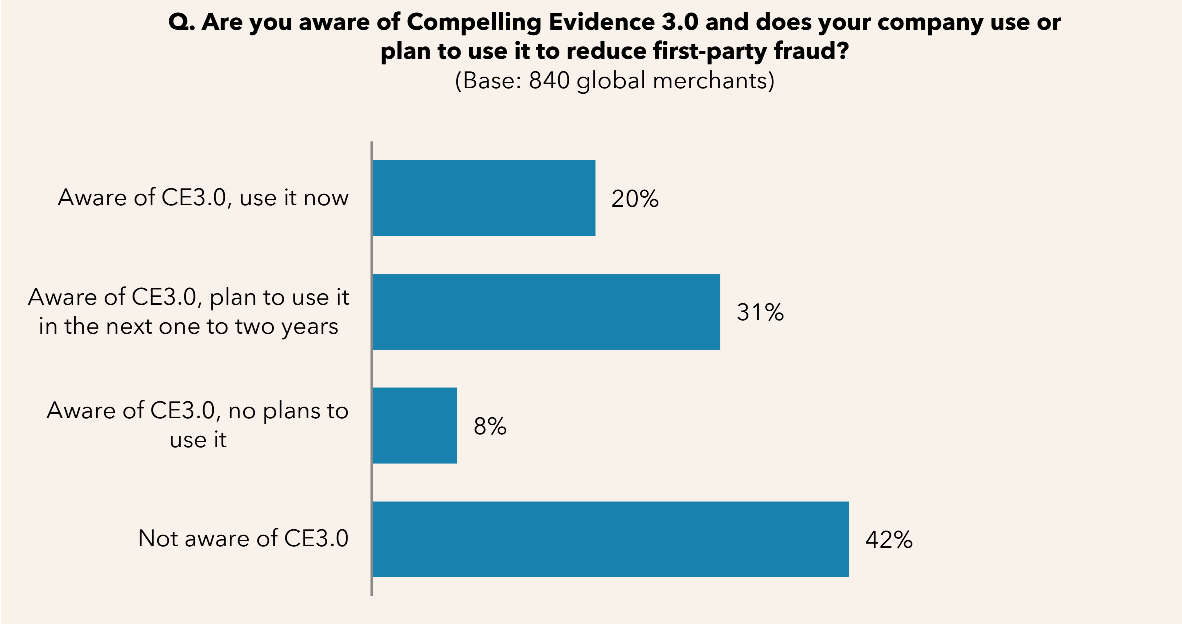


Source: Datos Insights Survey of 840 Global Merchants on Chargebacks, Q4 2024

Merchant Awareness and Support: CE3.0 vs. First Party Trust

Although CE3.0 has been in the market 18 months longer than First Party Trust, one would think that CE3.0 would have higher name recognition. However, 42% of merchants globally have never heard of CE3.0, while 8% have heard of it but have no plans to support it (Figure 12).

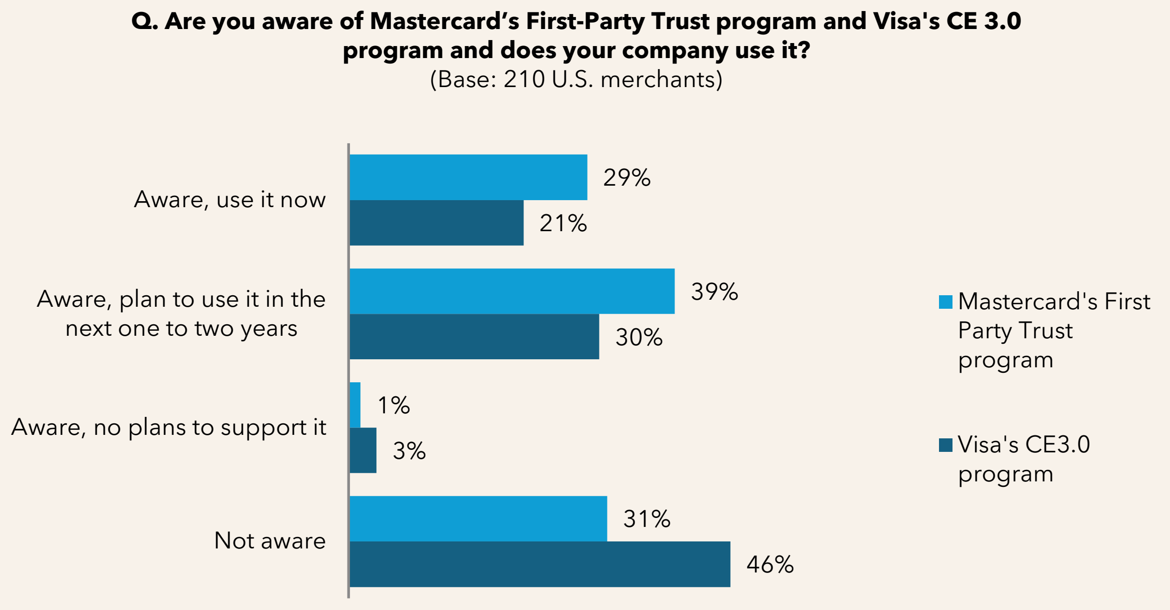
Figure 12: Global Merchant Awareness and Support for CE3.0



Source: Datos Insights Survey of 840 Global Merchants on Chargebacks, Q4 2024

Among U.S. merchants, there is a stark contrast in awareness and support for CE3.0 vs. First Party Trust. Fifty-four percent of merchants are aware of CE3.0 compared to 69% for First Party Trust. And more merchants have plans to support First Party Trust than CE3.0 (Figure 13). Considering the scale of the first-party fraud problem for merchants, it is surprising that awareness and adoption are not higher. The card networks and acquiring processors can do more to inform and educate merchants on the existence and benefits of these programs. Of the various industry types represented by the merchants in this report, those primarily engaged in subscription services have the highest awareness of these programs (70% are aware of CE3.0, and 87% are aware of First Party Trust) and the highest rate of current or planned usage (96% for CE3.0 and 100% for First Party Trust).

Figure 13: U.S. Merchant Awareness and Plans to Support CE3.0 and First Party Trust



Source: Datos Insights Survey of 840 Global Merchants on Chargebacks, Q4 2024

Merchants currently using CE3.0 are very satisfied, with 93% reporting it is effective or very effective at avoiding financial liability (Figure 14). With such high satisfaction ratings, it would benefit the industry to promote these benefits to merchants to increase the adoption and use of CE3.0. This would also provide trickle-down benefits to FIs by providing them with the data to refute a dispute claim with cardholders.

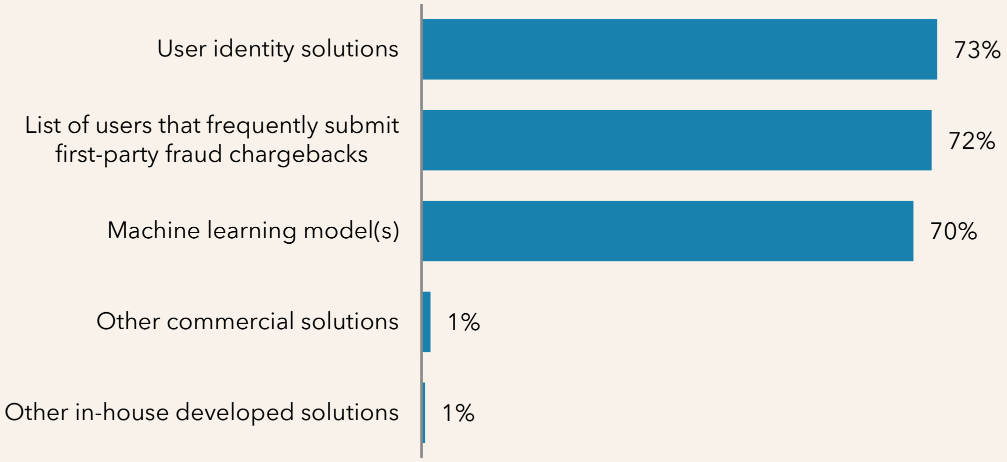
Figure 14: Effectiveness of CE3.0

Merchant Adoption of Other Technology

Forty-six percent of merchants are deploying other solutions to mitigate first-party fraud, ranging from high-tech to low-tech. High-tech solutions include user identity solutions and machine learning models while low-tech solutions include negative lists of users who frequently dispute transactions, leading to a chargeback (Figure 15). As with most fraud prevention frameworks, mitigation strategies are multipronged. No single solution will address first-party fraud; rather, a layered approach is needed.

Figure 15: Other Solutions Merchants Use to Mitigate First-Party Fraud

Q. Which of the following types of solutions do you have to identify and prevent first-party fraud chargebacks?
(Base: 388 merchants using other solutions to identify and prevent first-party fraud chargebacks)



Source: Datos Insights Survey of 840 Global Merchants on Chargebacks, Q4 2024

Looking Into the Future

Merchants provided a glimpse into the future of the chargeback industry and how it needs to improve:

- **Improved fraud detection:** The most efficient way to stem the rising tide of first-party and third-party fraud is by better embedding fraud detection at the point of authorization. This will require enhancements to AI and machine learning models that are deployed in real time to prevent fraud before it happens.

- **Enhancements to chargeback systems:** While fraud systems have employed advanced technology for years, chargeback systems need a shot of technology, too. Enhancements mentioned frequently include the need for automation to reduce manual processes, better integration with payment processors, and improved performance metrics tracking.

- **Better customer engagement and communication:** This can take many forms. The ideas mentioned most often include clearer policies and procedures, making refund policies more readily available, and improving communications with customers to avoid them disputing transactions with their card issuer.

Conclusion

First-party fraud has become a significant challenge for both FIs and merchants, with projected losses reaching US$3.9 billion in 2025 and growing to US$4.8 billion by 2028. The rise in e-commerce transactions, coupled with increased social media sharing of dispute tactics during the pandemic, has created an environment where consumers are more likely to dispute legitimate transactions. This trend shows no signs of abating, with 35% of FIs and two-thirds of merchants reporting year-over-year increases in first-party fraud cases.

While industry solutions such as Visa's CE3.0 and Mastercard's First Party Trust offer promising approaches to combat this issue, adoption remains relatively low despite high satisfaction rates among current users. The challenge requires a multifaceted approach combining technological solutions, improved customer communication, and enhanced operational processes. Both FIs and merchants must evolve their strategies to effectively address this growing form of fraud while maintaining customer satisfaction and operational efficiency.

FIs and Card Issuers:

- **Enhance collaboration between the fraud and disputes departments.** Through regular cross-functional meetings and data-sharing efforts, identify emerging trends and develop coordinated response strategies.
- **Track and monitor repeat disputers.** When fraud is claimed on a disputed transaction, a new card is commonly issued with a new card number. Tracking at the customer level, not the card number level, can assist FIs in knowing which customers are serial disputers and whether to deny dispute claims or possibly terminate the relationship.
- **Implement robust data-matching capabilities.** Compare merchant-provided CE3.0 data with internal mobile banking session data, increasing confidence in identifying legitimate first-party fraud cases.

Merchants:

- **Accelerate adoption of CE3.0 and First Party Trust programs.** Merchants, especially those in high-risk verticals such as subscription services and digital goods, can benefit from participation in these programs.

- **Deploy structured data gathering and retention systems.** To comply with the requirements of CE3.0 and First Party Trust, merchants need to collect and preserve certain key pieces of information about each customer's online transactions.
- **Consider new solutions to detect and prevent fraud and chargebacks.** Implement a layered approach to fraud prevention, combining user identity solutions, machine learning models, and negative lists of frequent disputers.
- **Enhance customer communication.** Make refund policies more accessible, clearly explain subscription cancelation processes, and proactively engage with customers before they escalate to their card issuer.

Acquirers/Processors:

- **Actively educate merchants.** Inform merchants of the benefits of CE3.0 and First Party Trust programs to increase adoption and reduce the cost of first-party fraud disputes and chargebacks.

About Datos Insights

Datos Insights is an advisory firm providing mission-critical insights on technology, regulations, strategy, and operations to hundreds of banks, insurers, payments providers, and investment firms—as well as the technology and service providers that support them. Comprising former senior technology, strategy, and operations executives as well as experienced researchers and consultants, our experts provide actionable advice to our client base, leveraging deep insights developed via our extensive network of clients and other industry contacts.

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