September 2011

Chargebacks are a challenging part of any online business, and for LivePerson/Kasamba expert sites (herein "LivePerson") it is particularly difficult. This document will help explain LivePerson's chargeback policy including what they are, why they happen and what we do to fight them.

Note: Chargebacks and Uncharged Sessions are two different challenges. This document seeks to specifically address the issue of sessions that are disputed in the form of a chargeback. In a future document we will provide similar data with regards to sessions that go into uncharged status.

What is a ChargeBack?

A chargeback is the return of funds to a Credit Card Holder, initiated by the Card Holder and the bank that has issued such consumer's credit card, most often in reaction to a disputed charge on the Card Holder's account. Specifically, it is the reversal of a prior outbound transfer of funds from a Card Holder's bank account, line of credit, or credit card (PayPal included). The chargebacks mechanism exists primarily for protection against merchants who unfairly charge a credit card. United States credit card holders are afforded reversal rights by Federal Reserve Regulation. Similar rights extend globally pursuant to the rules established by the corresponding card association bank network or local law.

A Card Holder may initiate a chargeback by contacting their issuing bank and filing a substantiated complaint regarding one or more debit items on their credit card statement. These days, especially as online banking is more and more prevalent; filing a dispute over a charge is a relatively easy process for a Card Holder.

How & Why Do Chargebacks Happen?

Charges on a credit or debit card can be disputed for a number of reasons. For users of the LivePerson platform, the dominant reason reported for disputes are that a Card Holder claims that he/she did not authorize or participate in using the LivePerson platform(i.e. that the person who participated in our services is not the actual Card Holder). Other reasons for disputes may include that the LivePerson platform is not as described or lack of satisfaction with the LivePerson platform services. Ultimately, all a Card Holder has to say is, "That wasn't me" in regard to using the LivePerson platform. It is LivePerson's responsibility to show a credit or debit card was used in good faith by a Card Holder who authorized and used the LivePerson platform.

Most chargebacks begin when a Card Holder reports a problem to the credit card Issuer. Before we look at the life cycle of a chargeback, here are a few definitions to understand:

"Card Holder" the owner of the credit card who is disputing the charge

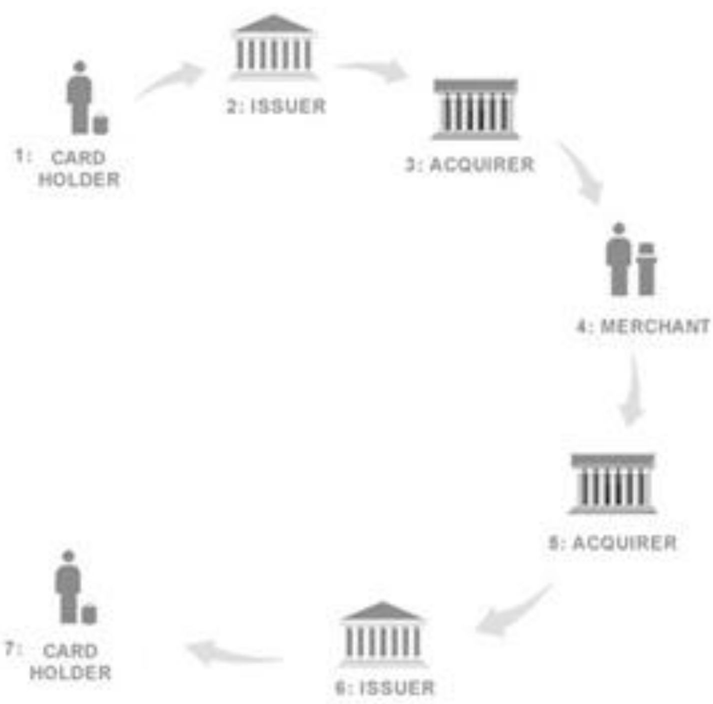
"Issuer" is the bank that sponsors the credit card (i.e. Bank of America)

"Acquirer" refers to LivePerson's bank /financial institution

"Merchant" is LivePerson

Below is an illustration and the steps that make up the chargeback life cycle.

Chargeback Lifecycle



Step 1: The Card Holder disputes the transaction, generally by filling out a short form via online banking website. Very little information is required from the Card Holder when filing a dispute.

Step 2: The Issuer credits the Card Holder's account the amount in dispute.

Step 3: Acquirer receives the chargeback and resolves the issue or forwards it to the Merchant .

Step 4: Merchant either accepts the chargeback or challenges the dispute charge and resubmits it to the Acquirer. Documentation of the validity of the charge must be presented to the Acquirer.

Step 5: Acquirer reviews the information from the Merchant. If the Acquirer agrees that the Merchant information addresses the chargeback the Acquirer resends it back to the Issuer.

Step 6: Issuer receives the information. If approved, the Issuer charges the amount to the Card Holder's account, removing the credit to the Card Holder noted in step 2. If the Issuer does not approve it, the Issuer may send the chargeback to the Credit Card Company for financial liability decision.

Step 7: The Card Holder receives the dispute resolution information and will either be re-billed for the disputed amount or the credit will remain on the account.

Important take away:

As soon as the Card Holder files a dispute, the amount being disputed is credited to their account. **The burden of proof that the charge was viable is *completely* on the Merchant.**

How Long Does the Chargeback Cycle Take?

A Card Holder has a ***minimum* of 60 days** (as granted by the Federal Trade Commission) from the date they first receive their credit card statement with the disputed charge on it to dispute a charge. However, Card Holders often dispute charges up to 90 days or more after the transaction has appeared on their credit card statement. Our experience at LivePerson shows that chargebacks are usually issued after 60 days on average, yet we have seen much shorter and much longer (120 days) time periods.

Frequently experts won't see a chargeback in their account until days, weeks and sometimes months after the chat charges being disputed took place. LivePerson has no control over when a Card Holder disputes a charge.

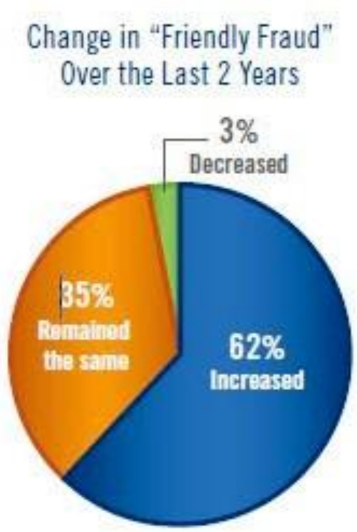
The Issuer must acknowledge the Card Holder's complaint in writing within 30 days after receiving it, unless the problem has already been resolved. And the Issuer must resolve the dispute within two billing cycles (but not more than 90 days) after receiving the Card Holder's dispute.

Between the time an expert chats with the presumed Card Holder and a final resolution on a chargeback a total of between 150 and 180 days may pass if the credit card only allows the minimum number of days for dispute. If an Issuer lets the client dispute after 90 days or more, this schedule is then extended as well.

Why is This a Bigger Problem for LivePerson vs. Other Companies?

We are in the business of offering an intangible service. There is nothing shipped to our clients, no physical goods or products are involved. We allow people to sign up to the LivePerson platform and consult with our experts. If the Card Holder disputing a charge claims that they did not authorize use of the LivePerson platform, that it was fraud or the credit card was taken without permission, they are eligible to report a chargeback. It is LivePerson's responsibility to bring the proof to the Acquirer that the charge was valid. **The main challenge here is that it's not easy to prove that the person chatting with our experts is actually the same as the Card Holder.** Chat transcripts are not considered tangible proof that Card Holder identity is the same as the person who engaged in the chats. If we were selling a physical product, we would have a stronger ability to validate disputes. For example, companies who ship physical assets can often show shipping receipts and/or signatures on received packages to validate identity.

"Friendly fraud," when a Card Holder disputes a charge claiming fraudulent use of their card when they in fact were the ones to authorize it, is reported to be on the rise. When online businesses were asked about their instances of friendly fraud over the past 2 years, **62% reported being the victim of friendly fraud**. This is one of the most common types of fraud that is identified in LivePerson chargeback disputes. Friendly fraud thrives in the online services market where it is much easier for fraud to be successfully carried out.



(source CyberSource 2011 Online Fraud Report)

How Can Chargebacks be Avoided?

The only way to significantly diminish chargebacks is for the Merchant to give the Acquirer "compelling information" to prove the identity of the customer is the same as the Card Holder. There are 2 ways to do this:

- Providing correspondence between the Card Holder and Merchant that proves the Merchant spoke to the Card Holder or received a letter from the Card Holder stating that they acknowledge the validity of the transaction ***before*** the transaction occurs.

- Evidence that the Merchant swiped or imprinted the card, received an authorization approval, and the Card Holder's signature, again before the transaction took place.

The challenge: both of these solutions *seriously* impede the online chat process making it more difficult to get the presumed Card Holder to chat with an expert. We don't want to scare off legitimate clients with a lengthy registration/approval process. Ever wait in a long line at the store and get frustrated and give up because it's taking too long? Ever get confused by a website's registration process and abandon the site rather than attempt to figure it out? We don't want that to happen. Our market tests have shown that it's better to take some risk to facilitate use of the LivePerson platform than to prevent potential use of the LivePerson platform with complicated or in-depth registration procedures.

Why Chargebacks are bad for LivePerson (not just experts)?

The Merchant's Acquiring Bank accepts the risk that the Merchant will remain solvent over time, and thus has an incentive to take an interest in the Merchant's products and business practices. Reducing chargebacks is crucial to this endeavor. To encourage compliance, Acquirers may, at their discretion, **charge Merchants a penalty per chargeback received**. What this means is that chargebacks don't just mean a loss of income, but are actually ***a significant cost to LivePerson.***

In addition, Issuer's may levy severe fines against Acquiring Banks that retain Merchants with high chargeback frequency. Acquirers typically pass such fines directly to the Merchant. Merchants whose ratios stray too far out of compliance may trigger card association **fines of $100 or more per chargeback (regardless of the amount being disputed).** This is another reason why it is in LivePerson's best interest to minimize chargebacks—to keep from being fined.

You will see more evidence below of LivePerson's commitment to fight chargebacks. Not only do chargebacks result in a loss of revenue, *and* a cost (fees mentioned above) but also a significant part of our operating budget is dedicated to anti-fraud measures.

What Does LivePerson Do to Fight Chargebacks?

The Billing and Anti-Fraud team at LivePerson receive daily notices of chargebacks that Card Holders have filed. We use all standard measures to prevent cards reported stolen or otherwise non-authenticated cards from being use on our system

On average – about .5% of all LivePerson expert transactions are disputed. That means that 99.5% of transactions completed annually are *not* disputed. How does that compare to the online ecommerce average? Actually, pretty good. Other online businesses report closer to 1% average of fraudulent disputes:

(source CyberSource 2011 Online Fraud Report)

Fraud Prevention is Key

The LivePerson Billing and Anti-Fraud team is constantly on the lookout for the suspicious behavior that leads to chargebacks, and they proactively block anyone they deem to be potentially fraudulent. **Every year LivePerson blocks 3,000 to 5,000 suspicious accounts.** The LivePerson team has a series of checkpoints to help identify suspicious behavior *(not outlined for security purposes).*

Once an account has been deemed suspicious, LivePerson does what it can to verify the validity of the presumed Card Holder. There are a variety of steps take to do this, here are a few of the steps that the Billing and Anti-Fraud team may take on:

- Call the Card Holder's bank to verify the user
- Call the presumed Card Holder to verify the phone number on file
- Have a conversation with the presumed Card Holder (documented); ask about their satisfaction with the site
- Verify billing information through a secondary process

Also, *all clients* who reach a monthly spend threshold will also go through a validation such as the one outlined above. Why? The more a client spends, and the velocity in which he/she spends, the more risk we take in the event they do chargeback. LivePerson has a high ratio of clients that return for additional sessions and reach a large number of transactions. If those transactions are disputed by the Card Holder (keep in mind Friendly Fraud which is very common to this scenario) the impact is very high.

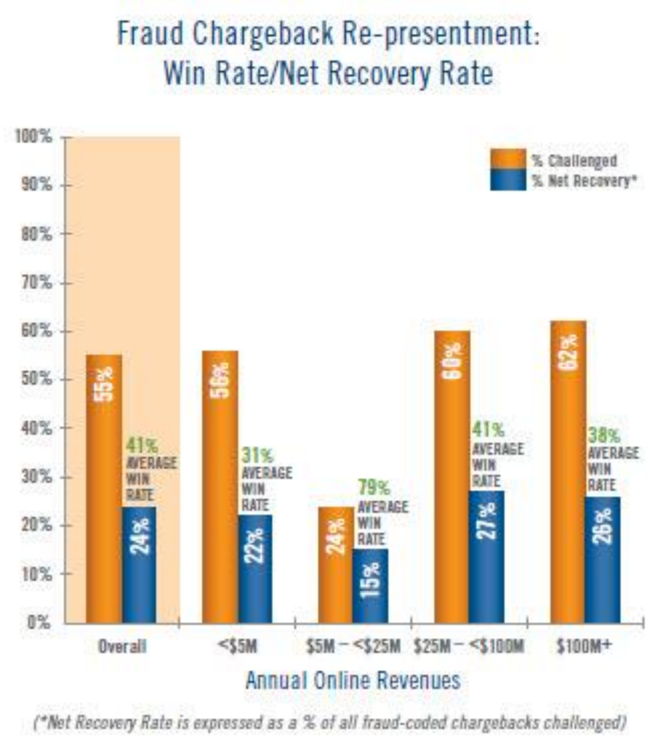
Taking fraud prevention even further:

LivePerson has contracted with an external company, the market leader in fraud detection, to help us identify fraud risks. They have insight into our operations and provide reports to help us identify, reduce and eliminate fraud risk.

When LivePerson receives a chargeback, **we attempt to fight every single one**—though historically this is not an easy win for us because of the reasons outlined above. Each chargeback requires several hours to process, manage and challenge. And just because LivePerson wins a dispute does not mean the Card Holder won't file a second dispute to challenge the results.

In general **across all online Merchants only 41% of all chargebacks due to fraud that merchants challenge are recovered** (source: Cybersource 2011 Online Fraud Report). Since the average Merchant only challenges 55% of chargebacks that means a net recovery rate of only 24% of all chargebacks result in a recovery of funds for the Merchant. Again, there is no guarantee that Card Holder won't issue a additional chargeback if they lose the dispute the first time. There is no limit to how many times a Card Holder can attempt to dispute a charge.

What these statistics suggest: Card Holder's take NO RISK when making a claim of fraud to their credit card company. Less than half of such challenges are awarded to the merchant. **The customer wins the dispute 76% of the time**.



A few last words:

LivePerson recognizes that chargebacks are a difficult part of doing business online. There is inherent risk when you don't physically swipe a credit card and get the Card Holder's signature and this risk is a part of any online business. LivePerson also recognizes that chargebacks are not just an annoyance, but have a negative impact on each of our experts' bottom line. That's why we take them seriously and continue to step up our investments in fighting fraud, even as "fraudsters" become more savvy and sophisticated year after year.

In response to experts' requests, the LivePerson Development team will be updating the expert accounting screens to provide more information to experts about each individual chargeback and uncharged session. This will likely be rolled out sometime in the first quarter of 2012, though a formal completion date for this initiative has not been announced at the time of publishing this document. In the meantime, experts who have specific questions about consumer transactions should contact the support team for more details.

What can you do to help?

If you suspect a client of fraudulent activity send an email to **consumer.security@liveperson.com** —the more information you can provide about your concerns with a particular customer, the better. Ultimately it's in both the experts and LivePerson's best interest to catch fraud as soon as possible to eliminate the possibility of chargebacks in the first place.

Resources:

Federal Reserve Regulation

Federal Trade Commission

Wikipedia®

Cybersource 2011 Online Fraud Report

Visa® Chargeback Information

Ari Strauss, Billing and Anti-Fraud Manager