**Debit Cards**

Welcome to this podcast on Debit Cards brought to you by CALI. I am Professor Jennifer S. Martin. The topic of this podcast is to introduce the basic attributes of debit cards and how the payment system handles error and fraud. So, how prevalent is the use of debit cards? You probably have one. You might not be surprised then that credit and debit cards collectively were used for two thirds of all non-cash payments in the United States in 2015. The number of credit card transactions though is about half of the number of debit card payments, but the value of those transactions is actually more than that of debit cards. Debit cards, though, had the largest increase in the number of payments of any of the major group of payment devices. While prepaid debit cards are part of this debit card increase, most of the growth occurred in traditional non-prepaid debit cards. To get an idea of the size of the market, there were 69.5 billion debit card transactions in 2015 with a value of $2.5 trillion dollars.

Debit cards and credit cards, though, have different attributes and governing law, even though they share some features. For instance, while debit cards are governed by the rules of the federal government’s Consumer Financial Protection Bureau (CFPB) contained in Regulation E, the rules governing credit cards appear in the CFPB’s Regulation Z. The Federal Reserve System also retains regulatory authority over lending and, therefore, both debit and credit cards. Regulation E takes up issuance of debit cards, disclosures, liability for unauthorized transactions, and even overdraft protection.

So, how do debit cards work? Well, a debit card basically operates in transactions in the same way that historically bank customers used paper checks. Both the debit card and a check are linked to a bank account from which money is removed when the transaction is completed. The use of the debit card eliminates the need for a paper check by using electronic impulses at a terminal at a point of sale to authorize payment for the transaction. While some of the attributes of debit cards and checks are similar, Article 4A of the UCC, which governs checks, does not apply to debit cards. This is true even though Regulation E is not preemptive in nature. There are some points of regulation where states have some particular coverage for debit cards, but that coverage is not part of the UCC.

Have you ever thought about how the debit card process works? When it comes to using a debit card for a point-of-sale transaction the transaction itself may resemble the same process generally used as a credit card from the consumer’s perspective. One difference is that the customer may enter a pin (personal identification number) or provide a signature at the electronic terminal. Also, upon receiving the authorization, the transaction is completed immediately and the money is removed from the customer’s account. A credit card transaction, by contrast, is based upon a line of credit, which is not paid by the consumer until later. Debit card transactions are processed over a network, such as Visa or MasterCard. Debit cards are also often used with a pin at an ATM machine if a customer wants to perform transactions ordinarily done directly with the teller at the bank, such as withdrawing money. It is of note that some transactions actually do not settle immediately, such as the purchases of gasoline at a gas station, but in such situations there is still an online authorization transaction while the customer is at the point of sale terminal. The bank still confirms availability of funds for these type of transactions leading to a hold on those funds in the customer’s bank account and the removal of the funds from the account at a later point in time.

So back to the law. Regulation E provides rules on how a customer might obtain a debit card. Most importantly, most bank debit cards are of a solicited nature and fall into two categories. First, when the customer requests orally or in writing to have a debit card. But second, a bank may issue a replacement card for an already accepted device. Replacement cards are quite common often due to concerns of fraud or emerging technology, such as the issuance of new chip cards to replace cards with magnetic strips. Moreover, issuance of debit cards requires banks to abide by upfront disclosures on terms and conditions and this is actually required by Regulation E. Additionally, there are more limited rules for banks to send unsolicited cards in an un-validated state with specified disclosures and information for validation, though perhaps this is less common for most of you.

Because debit card transactions settle at the time of the transaction, there is no ability of the customer to stop payment on the transaction in the way that a customer might if they were paying using a paper check. As such, the transaction really is final at that time, absent error or fraud. While error does not seem to be a significant problem with debit cards, in terms of loss, fraudulent transactions have been problematic for both debit and credit cards. Because debit cards can be used with or without a pin, the loss exposure is much like that of credit cards. Of course, if too much risk for loss was put on the consumer, then consumers simply would not want to use the cards. Accordingly, Regulation E presents an allocation of risk between the customer and the bank issuing the card.

Protections for debit card losses fall into several categories. First, Regulation E protects customers from any loss unless the issuing bank uses security measures such as pin, signature, photograph, or other identifying means. Second, when considering a number of losses arising from the same theft, Regulation E considers the loss to be single in terms of any imposition of any liability on the consumer. Third, the rules regarding imposition of liability on the consumer are drafted to encourage the consumer to report the loss of the card at the earliest point in time. For instance, a consumer is only responsible for up to $50 initially with respect to losses from unauthorized use. However, if a consumer fails to report the loss of the card for two days after knowing the card was stolen, then the consumer is responsible for a total of $500 beginning on the third day. This fault-based rule continues with a companion rule that actually places all liability on the consumer who does not report the loss of the card with respect to unauthorized transactions that could have been prevented more than sixty days after receipt of the statement revealing the unauthorized transaction. Now, most of us will notice when our bank account suddenly has less money or perhaps is empty due to theft, so oftentimes, getting customers to report the loss is not difficult.

While Regulation E mandates certain protections for consumers, some banking institutions and networks provide greater protections for consumers. Likewise, some states also provide more generous protections. For instance, both MasterCard and Visa limit consumer liability to $50 within the first sixty – day timeframe.

Perhaps you’ve been the victim of debit card fraud yourself, but imagine having a thief use your debit card to empty your bank account! You might even have your debit card in your wallet, but the thief has obtained the data or made a duplicate card. At this point in time you may find yourself with no money. The lack of immediately available funds often provides incentive for the consumer to report the loss to the bank promptly. Even if you report the transactions, though, the bank still has to investigate the claim. Regulation E provides ten business days for such an investigation or the bank must provide a re-credit for the disputed amount. Visa and MasterCard provide greater protection and require participating banks to make a re-credit within five days. Many banks provide even greater coverage than Regulation E requires. Most of us do not want to go five or ten days without any money in our checking account.

One last part of Regulation E is of note. Amendments to Regulation E adopted in 2010 addressed issues with respect to overdraft fees charged by banks. An overdraft is simply when a consumer has insufficient or unavailable funds in their account to cover a new transaction. While financial institutions offer overdraft services whereby the bank pays an item even when there is not sufficient money in the account, the fee for such transactions is often $35 per item or more. You might imagine going to buy an expensive cup of coffee for $5 at Starbucks and using your debit card. If you had overdraft protection you might not know that you did not have money in your checking account. You will end up paying $5 for the coffee, plus $35 for an overdraft charge.

The revised regulations require customers to opt in to an overdraft system for debit cards. Even if the customer does not opt in with respect to debit card transaction overdraft services, the customer can still participate in overdraft protection for other transactions on the customer account, such as checks.

At this point, you should be able to identify the primary attributes of debit card transactions, the applicable legal rules for their use, and the defenses for unauthorized charges, including the rules associated with notice by the consumer to the bank.

I hope you’ve enjoyed this podcast on Debit Cards.

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