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## The dark secrets of debit

Why do banks push debit cards for every purchase you make? Because they stand to make millions--largely at your expense

An excerpt from **ConsumerReports**  
**MoneyAdviser**

Quietly but surely, a revolution is under way in how we pay for everything from a cup of coffee to our monthly electric bill. Continuing a climb that started a decade ago, debit cards are now preferred over credit cards by those American consumers who use plastic for their in-store purchases.

Spending on these cards, which directly tap your checking account, topped \$1 trillion for the first time in 2006, when the total number of transactions outnumbered those on credit cards by more than 2 billion. With check writing in decline and little if any growth in ATM cash withdrawals, debit cards are becoming the dominant form of payment for consumers, according to a 2006 Federal Reserve Board research report. Debit cards are especially popular among women and among people between the ages of 18 and 25, who card issuers label Generation P, for plastic.

The convenience of not having to carry cash and a desire to avoid credit-card finance charges are among the many reasons consumers cite when asked in surveys why they prefer using debit cards. But banks are also accelerating this trend by aggressively promoting perks such as air mileage and other reward programs to entice cardholders to use debit cards more often. (For more information on those reward programs, see "[Debit rewards deceptive.](#)")

Of course, the card issuers have their own motives for encouraging you to reach for your debit card more often, some of which can hit you in your wallet. If you pay off your balance in full each month, a no-fee credit card is a better choice than a debit card because it allows you to keep your cash in an interest-bearing account until the card bill is due. Moreover, the cash-back, mileage, and other rewards that accompany credit cards tend to be much more generous than debit-card perks. Plus, credit cards provide more leverage if you get into a dispute with a merchant over something you've bought.

But if you're among the growing legion of debit-card fans, here's what you need to know to help you determine when it makes sense to use them and how to avoid the potential pitfalls when you do.

### TUG OF WAR OVER PAYMENTS

There are two basic ways to pay with a debit card. When you authorize a transaction by entering your personal identification number, or PIN, your bank account is debited immediately. If you opt instead to authorize payment by signing a sales slip, as you would for a credit card, the payment is processed through a credit-card network and the actual withdrawal from your account occurs later--usually within a couple of days.

Retailers generally prefer that you use PIN transactions, while banks encourage you to sign for purchases by offering mileage points or other incentives for signature-based debit payments. And some banks--including 7 of the top 100 surveyed by Bankrate.com--charge you a fee ranging from 25 cents to \$1 for each in-store PIN-based transaction as further incentive for you to sign for the purchase.

That's because signature transactions are more profitable for banks. The interchange fees that banks get from merchants for processing signature payments is much higher than for PIN-based transactions. On a \$100 purchase, for example, the bank that issued the card typically collects only about 20 cents in interchange fees when payment is made using a PIN. But it gets \$1.48 if the customer signs to authorize the purchase, says Avivah Litan, a senior analyst at Gartner, an information technology research company in Stamford, Conn.

Those higher interchange fees--which merchants ultimately pass on to consumers in the form of higher prices--are a substantial source of new revenue for banks. A 2007 report by the Mercator Advisory Group, a company in Waltham, Mass., that does research for the payment industry, underscores how much those fees add up. The report says that if a card issuer with 350,000 customers persuades them to increase their signature-debit transactions from five per month to nine, it could increase its interchange-fee income by nearly \$5 million a year.

### RACKING UP OVERDRAFT FEES

Since research shows that consumers who use debit cards more often are also more likely to overdraw their checking accounts, card-issuing banks can reap an additional \$1 million from nonsufficient-fund fees, according to the Mercator report.

Another study revealed that customers who used debit cards more than 20 times a year paid an average of \$223 in NSF fees annually, compared with \$40 for those who didn't use debit cards at all.

Until 2003, banks routinely declined debit-card purchases and ATM transactions for amounts that exceeded a customer's balance unless he or she had decided to link the account to a line of credit, credit card, or savings account to cover overdrafts. But since then, the number of banks using overdraft software packages has increased 80 percent. The software allows banks to pay overdrafts without alerting customers that they are exceeding their balance, according to the Center for Responsible Lending, a consumer advocacy group. Customers don't realize that they'll be charged a fee, which average more than \$30, if they proceed with the transaction. This fee is essentially a finance charge for a short-term overdraft loan, which the bank swiftly recoups from the account holder's next deposit. When translated into an annual percentage rate, overdraft fees on debit cards can exceed 1,000 percent.

"You may use a debit card to avoid paying high interest on credit-card balances, but when you're hit with what amounts to high-cost overdraft loans, your debit card can quickly become the most expensive credit card on the market," says Eric Halperin, director of the Washington, D.C., office of the Center for Responsible Lending. The group estimates that consumers pay \$17.5 billion in overdraft loan fees annually--nearly half of which are triggered by debit-card transactions or ATM withdrawals.

Consumers not only overdraw their accounts when they fail to keep track of all of the lattes or newspapers they've bought with debit cards, but a practice called "blocking" can also increase the odds that overdrafts will occur. Some hotels, gas stations, and other retailers put a hold on funds in your checking account until a debit transaction is processed--which can take from one to several days for signature-based payments. What's more, the amount that's blocked can significantly exceed the actual amount of your purchase.

"When you swipe your debit card for \$25 worth of gasoline, \$100 of your account balance may be temporarily blocked because the system doesn't know if you're filling up a Miata or an Explorer until the transaction has settled," says Greg McBride, a senior financial analyst at Bankrate.com. "If you're running a low account balance, blocking can lead to multiple overdrafts, which is why debit cards may be fine for buying a cup of coffee but not so good to use for rental cars or hotel bills, where blocking can tie up hundreds of dollars."

To avoid being hit with costly bounce-protection fees, McBride recommends that you record all debit transactions in your check register and regularly monitor your account balance online. He also advises that you sign up for overdraft protection linked to a savings account.

## UNEQUAL FRAUD PROTECTION

Under federal law, your liability for fraudulent charges on a debit card can be greater than it is for a credit card. With a credit card, you're only responsible for up to \$50 in unauthorized purchases. But with a debit card, you can lose up to \$500 if you don't report the theft or loss of your card or PIN within two business days of discovering the problem. And if you fail to report the unauthorized charges within 60 days of the date of the statement that lists them, you could be held liable for any unauthorized withdrawals after that date. Those include the full value of credit lines and funds in savings linked to your checking account for overdraft protection.

In practice, Visa and MasterCard both have "zero liability" policies that go beyond the federal law by exempting debit cardholders from liability in most cases when a bank investigation confirms a transaction is fraudulent. But there are loopholes in those policies.

Even if consumers were granted liability protection that is identical to that for credit cards, the headaches of setting the record straight are much greater with fraud on a debit card, says Ed Mierzwinski, consumer program director at the U.S. Public Interest Research Group. "Unlike a credit card, payment for a fraudulent transaction has already come out of your bank account, so you're fighting over your money, not theirs, and you could be bouncing other checks while you're waiting for it to be resolved," he says.

What's more, while there have been a few well-publicized security breaches involving the theft of debit-card PIN numbers by hackers breaking into store computer databases, retailers generally report that the incidence of fraud is higher when consumers sign for debit purchases rather than using a PIN. "Signature-based transactions are definitely less secure, so it's really outrageous that banks are steering customers to use signatures rather than PINs simply because it generates more fee income," says Avivah Litan. One major retailer confided to her that fraud on signature-based debit purchases at his company's stores is 15 times higher than for transactions authorized by a PIN.

Ironically, although your odds of becoming a fraud victim are lower when you use a PIN, your protection from liability if fraud does occur is greater with a signature debit card because card issuers may exclude some types of PIN transactions from their zero-liability policies. Litan advises calling your card issuer to find out what your liability is for unauthorized signature vs. PIN debit purchases. She says that since banks encourage the use of signature debit, you're likely to have better protection when you sign.

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