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**MEMORANDUM**

September 10, 2003

To Our Clients and Friends

Re: Regulation E and Debit Card Identification

**BACKGROUND**

In June 2003, the litigation regarding debit card acceptance that was brought by Wal-Mart and other merchants against the Visa and MasterCard credit card associations was settled. As part of that settlement, the card associations agreed to implement changes that will make it easier to identify debit cards. The changes could affect on-line and telephone compliance procedures under Regulation E (Electronic Fund Transfers) by merchants that bill consumers' debit cards on a recurring basis (e.g., monthly, quarterly or annually).

**OVERVIEW OF REGULATORY REQUIREMENTS**

Under Regulation E, a merchant is required to obtain a customer's authorization for a recurring charge to a debit card in a signed writing or by another means that is "similarly authenticated." The Federal Reserve Staff Commentary to Regulation E allows for inadvertent acceptance of a debit card by a merchant where the merchant does not obtain the appropriate authorization for a recurring billing. However, in order to take advantage of this safe harbor under Regulation E, a merchant is required to have a procedure in place to determine if a card is a credit card or a debit card. Regulation E does not provide guidance on the requirements for this card identification procedure. Some merchants comply with the safe harbor by asking the customer whether the card is a debit or credit card. Because, at present, there is nothing on the card that readily distinguishes a debit card from a credit card, many customers mistake their debit cards for credit cards. Beginning next year, debit cards will be more readily identifiable to consumers and merchants.

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### **DEBIT CARD IDENTIFICATION**

After January 2004, card issuers will phase in a new logo on the front of each debit card that will indicate it is a debit card. These unique debit card identifiers will be phased in over a multi-year period, so the new logo will not appear on all cards as of January 2004. The card associations are also required under the settlement to develop an electronic means using Bank Identification Numbers (BINs) for merchants to identify whether a card is a debit card. There is no detail available as to how this electronic identification system will be implemented, whether the system will be available for just new customers, or whether the system could be applied to existing customers that are already enrolled in the merchant's service.

### **OPERATIONAL CONSIDERATIONS**

In light of the new card identification processes, merchants may want to consider revising their current procedures used to identify whether a consumer is presenting a debit card or credit card for payment for a recurring charge. For example, merchants may want to consider revising their web sites or telephone scripts to direct cardholders' attention to the unique debit card logos that will be on the front of the card in order to determine whether it is a debit card. However, because not all debit cards will have the card association-required debit logos until 2007, the fact that the debit logo is not on the card does not necessarily mean the card is a credit card.

Merchants also may want to contact their card processor to determine the status of the electronic identification program for debit cards, and how it will be made available to the merchant. Lead time may be necessary to make changes to computer and communications systems that are used for card processing.

As a result of both the electronic identification system and the new logos on debit cards, merchants should anticipate that they will identify more customers as seeking to pay with debit cards. Merchants will need to have procedures to obtain authorizations from these customers for recurring billings or to have these customers provide a credit card as an alternative payment method.

### **POSSIBLE REGULATORY CONSIDERATIONS**

At this time, there has been no indication that the Federal Reserve will issue any new guidance regarding card identification procedures under the Regulation E safe harbor in light of the anticipated new card identification processes. However, it is possible that new regulatory guidance could be issued. Potential regulatory questions include: whether a recurring merchant will be required to use the

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electronic card identification system to identify debit cards, or if such a system will be optional; and whether recurring merchants will be required to review their existing customer portfolio to determine if any of the cards are debit cards. The Federal Trade Commission may play a role in this regulatory process, for the FTC has enforcement jurisdiction (but not interpretive jurisdiction) for Regulation E as it applies to non-bank merchants.

If you have any questions concerning this memorandum, please call Gilbert Schwartz, Robert Ballen, or Thomas Fox at (202) 776-0700. In addition, please feel free to visit our website for updates and links to financial institution regulatory materials. The website address is [http://www.schwartzandballen.com/whats\\_new.html](http://www.schwartzandballen.com/whats_new.html).