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Legal Challenges to Applicant Credit Checks

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Employers face rising criticism regarding their use of credit histories in hiring decisions. Civil rights advocates raise concerns that use of credit histories unfairly disadvantages certain segments of the population. Advocates for low-income individuals are concerned about the "Catch-22" for job applicants: One cannot re-establish credit without a job, and one cannot get a job with bad credit.

All levels of government have taken notice. As a result, an employer's use of credit histories in hiring decisions could be risky. This advisory explains the current state of the law and presents a number of precautions to protect from a future lawsuit or agency complaint.

Legislation

Currently, five states—Washington, Oregon, Hawaii, Illinois, and Maryland—severely restrict employers' use of credit information regarding job applicants and employees. All five states require that employers may only obtain applicant credit histories where the information in the credit report is related to the individual's job. In Washington and Oregon, for example, an employer can only obtain a credit report when it is substantially related to the individual's current or potential job or required by law. Washington requires that the employer disclose to the applicant in writing its reasons for the use of the credit information. Oregon's statute exempts federally insured banks and law enforcement employers, confirming that they may always obtain credit checks.

In Hawaii, Illinois, and Maryland an employer may only use a credit check in hiring decisions where the information relates to a bona fide occupational qualification. All three states exempt certain financial institutions from the requirements. The Illinois statute provides only seven possible "bona fide occupational requirements" that will satisfy the law. These include positions that involve: bonding or security; unsupervised access to more than $2,500; signatory power over businesses assets of more than $100; management and control of the business; access to personal, financial or confidential information, trade secrets, or state or national security information; or considerations as otherwise allowed by state or federal law.

Legislation is pending in 18 additional states, including California (Assembly Bill 22), that will provide similar restrictions on employers' use of credit checks.

The EEOC and Title VII disparate impact discrimination theories

In addition to individual state laws, the Equal Employment Opportunity Commission (EEOC) actively seeks to restrict employers' use of credit checks. Although credit history is not a protected characteristic under Title VII of the Civil Rights Act of 1964, the

EEOC has taken the position that employers' use of credit histories can have an unlawful disparate impact on racial minorities. According to the EEOC, a Freddie Mac National Consumer Credit Survey from 2000 underscores the disparate impact theory, finding that 48 percent of African-Americans had "bad" credit records compared with 34 percent of Hispanics and 27 percent of Caucasians.

A disparate impact is not unlawful per se under Title VII, but requires that the policy be justified by business necessity, and there must not be a less discriminatory alternative. To meet this standard, according to the EEOC, an employer must show, among other things, that its credit check requirements accurately measure whether applicants possess the qualifications needed for a particular position. The EEOC indicated that several studies have found that credit histories are poor indicators of job performance.

To reinforce its position, in December 2010, the EEOC filed a nationwide lawsuit in Ohio against Kaplan Higher Education alleging that Kaplan's practice of using credit histories in hiring decisions disproportionately impacts racial minorities in violation of Title VII.

The U.S. Bankruptcy Code is not a likely source of protection for job applicants

Recent cases confirm that only current employees and not job applicants are protected from adverse employment actions because of a history of bankruptcy. For employers who conduct credit checks on applicants (either in compliance with applicable state law or in confidence that the requirement does not present a disparate impact), the question often focuses on the evaluation of the results, including prior bankruptcies. Section 525(b) of the Bankruptcy Code provides that employers may not terminate or discriminate against individuals due to their involvement in bankruptcy proceedings.

Significantly, the U.S. Court of Appeals for the 3rd Circuit recently held that Section 525(b) only protects *current* employees and does not protect job seekers. *Rea v. Federated Investors Company*, 627 F.3d 937 (3rd Cir., Dec. 15, 2010). The 5th and 11th Circuits have both recently issued similar decisions. See *Myers v. Toojay's Management Corp*., ___ F.3d ___, No. 10-10774 (11th Cir. May 17, 2011); *In re Burnett*, ___ F.3d ___, No. 10–20250 (5th Cir. Mar. 4, 2011).

The Fair Credit Reporting Act

Where employers use credit histories in the hiring process, they must consider the application of the Fair Credit Reporting Act (FCRA). The FCRA authorizes the use of credit information for employment purposes; however, employers must notify the individual of their intent to obtain a credit report and obtain the individual's authorization. If the employer takes adverse action based on the credit report, it must provide the individual with a copy of the report and a description of rights under the FCRA. In requesting the credit report, the employer must certify that it has and intends to comply with these requirements.

Under the FCRA employers must also comply with Title VII as to *how* they use credit information. In the initial request for a report, the FCRA requires the employer to certify

that "information from the consumer report will not be used in violation of any applicable Federal or State equal employment opportunity law or regulation." 15 U.S.C. § 1681b(b)(1)(A)(ii). The EEOC has cited this provision of the FCRA in support of its position that the use of credit checks may be unlawful where it has a disparate impact on a protected class.

Employers should also remember that states may have additional procedural requirements for employers who seek credit reports for employees or applicants.

Advice for employers

For maximum protection from liability, employers should restrict the use of credit checks to positions where there is a business necessity. Given the novelty of lawsuits dealing with this issue, it remains to be seen exactly what types of "business necessity" will satisfy the EEOC and courts. The available guidance from the EEOC and courts suggests that employers should do the following:

- Evaluate each position for which the company wishes to complete a credit check to ensure that there is a legitimate business necessity. A good rule of thumb is to follow the standard required by several state statutes: The information in a credit report must be substantially related to the job responsibilities of the position.
- Determine that there is no "less discriminatory" way to obtain the information. It may be difficult to prove business necessity if the same information is available without a credit check.
- Keep a record of the analysis of the value of the credit checks and conclusion in the event that the use of credit checks is challenged.
- Have a written job description or policy for each position that includes a description of the business purpose for the credit check. For example, the policy may state that the job requires someone who "has a demonstrated ability to be fiscally responsible."
- Avoid a policy of automatically rejecting applicants based on poor credit. Instead, ask applicants about their adverse credit histories. Even where there is a business necessity for the credit report, the EEOC has indicated that it wants to see that employers are measuring "the person for the job and not the person in the abstract."
- Ensure your policy for pre-employment credit checks is consistent with the law in your state.