

Credit Checks And Hiring

Law360, New York (February 8, 2011) -- Companies that use applicants' credit histories when making hiring decisions face the risk of a possible discrimination lawsuit. Last month the U.S. Equal Employment Opportunity Commission sued Kaplan Higher Education over its use of credit histories claiming that this practice has a disparate impact on African-American job applicants.

In November 2010, a putative class action complaint was filed against the University of Miami and its medical school alleging that the use of credit histories discriminates against African-American and Latino job applicants. In addition, the EEOC held a public meeting in October of 2010 to examine and discuss the use of credit histories as employee selection criteria.

The severe economic downturn since 2008 and the collapse of the real estate market in many states has led to record numbers of mortgage foreclosures, bank write-downs of credit card debt and a substantial increase in personal bankruptcy filings. Consequently, many of the nearly 15 million unemployed Americans who are applying for jobs have damaged credit histories. As employers increase hiring in 2011 they must decide for which positions credit histories will be used as hiring criteria and what factors could mitigate against a job candidate's weak credit history.

Despite the risk of potential lawsuits, there are steps that employers can take to mitigate their legal liability from the use of credit histories. These include: 1) narrowing the use of credit checks to positions for which an applicant's credit history has relevance; 2) allowing other factors to mitigate the influence of a weak credit history; 3) giving applicants an opportunity to correct or explain items in their credit report; and 4) understanding the Fair Credit Reporting Act and state laws that regulate employers' use of credit histories.

If minority applicants receive disproportionately fewer job offers after the credit history screening process, the EEOC is likely to require the employer to provide information indicating that this screening process is a business necessity. However, there are ways that employers can use their applicant and personnel data to gather information to assist in this process. If job candidates hired into certain positions, despite weak credit histories, have poorer job performance, this evidence could validate the use of credit checks in hiring decisions.

How Credit Checks Are Used by Employers

Although about 60 percent of companies use information from credit histories when making employment decisions, the majority of these companies only perform credit checks for targeted positions within the company. In addition, most companies conduct credit checks only for job candidates who have been interviewed and/or have received a conditional job offer.

When requesting a credit check an employer informs the consumer reporting agency of the purpose of the credit check. This means that the credit check received by an employer does not contain a credit score, but instead provides a credit history of the applicant.

Because the credit histories provided to employers do not contain a numerical score, an employer's evaluations of credit histories are likely to be categorical. The simplest example of such a system would be to assign two possible grades to a credit history, green or yellow. Applicants receiving green grades require no further examination of their credit histories. In contrast, credit histories with yellow grades require closer examination, including a possible explanation of problematic items or consideration of mitigating factors. Consequently only a fraction of persons in this category may receive final job offers.

Regardless of the evaluation system, employers should use clearly defined criteria to evaluate and grade credit histories. These criteria may include the number of delinquent accounts, the number of accounts that have been referred to a collection agency or other indicators of a weak credit history. It is also advisable to follow the same review process for applicants who receive the same grade. In other words, if some applicants receiving a yellow grade are allowed to correct or explain items in their credit history, the same opportunity should be given to all applicants who received that grade.

Why Credit Checks Are Used by Employers

Some job applicants omit previous employers from their resume or application if their performance evaluations were poor, they were fired for cause or other problems occurred during the employment relationship. Therefore employers may use a credit check to obtain a list of an applicant's former employers so that they may question an applicant about employment experiences that were omitted from a resume or application.

Employers may use credit checks to gather information about an applicant's decision-making skills, financial responsibility and other qualities that they believe are directly related to job performance. Employers also use credit checks for applicants seeking positions with access to sensitive financial or customer information. These employers may be concerned that employees facing financial difficulties may be more tempted to steal, embezzle funds or sell sensitive information to other parties. Finally, some employers may be required by law to perform credit checks on applicants to certain positions.

Adverse Impact Analyses

To determine the adverse impact of using credit checks in hiring decisions, it is instructive to measure the rate at which final job offers are made among job candidates for whom credit checks were performed. It is also useful to compare the representation of minority candidates and reference group candidates across the different credit history evaluation categories.

In the simplest case this requires a comparison of the fraction of minority and reference group candidates who received a yellow grade. Because the hiring criteria can vary from one position to another, it is important that each of these analyses control for the position to which a candidate applied.

If after the credit history screening minority candidates were less likely to receive a final job offer than reference group candidates, the EEOC could allege adverse impact. Adverse impact could also be alleged if minority candidates were more likely to receive a lower grade on their credit history. If either of these patterns is apparent in an employer's applicant and hiring data, it is instructive to examine the validity of credit histories as hiring criteria.

Validation Studies

Unfortunately, there is no commonly accepted set of occupations where a solid credit history should be considered a prerequisite for employment. While there are some studies that correlate information from credit histories with job performance, different employers use different aspects of credit histories as selection criteria for different types of positions and therefore, it would be difficult to generalize from such studies.

Consequently, employers should assess the validity of credit histories as hiring criteria by examining the relationship between credit histories and objective measures of subsequent job performance using their own applicant and personnel data.

A properly conducted validation study can indicate whether an employer might consider curtailing the use of credit checks for certain positions. It can also point to whether the criteria for assigning yellow or green scores to credit histories should be reexamined and possibly amended.

The purpose of a validation study is to determine whether applicants with stronger credit histories had significantly better subsequent performance on the job. In order for a validation study to have statistical power, job performance measures must vary in a meaningful way among employees.

For example, if almost all employees receive a satisfactory evaluation after 90 days on the job, it is unlikely that any hiring criteria could be validated by its correlation with the 90 day performance evaluation. Similarly, although credit histories may be used to screen out a small minority of job candidates who might steal, it is unlikely that any hiring criteria could be validated by comparing the rate at which employees are fired for theft among individuals with different credit history evaluations.

A comparison of objective job performance evaluations, if they vary in a meaningful way among new employees, can be a useful way to assess the validity of hiring criteria such as credit histories. Other indicators of job performance could be citations for disciplinary problems, absenteeism or tardiness.

If credit histories are indicators of a job applicant's personal responsibility, it would be most instructive to correlate credit history evaluations with subsequent indicators of job performance that are the most likely to be associated with maturity, responsibility and sound decision-making.

A validation study compares the job performance of employees in the same job with stronger and weaker credit histories to determine whether there is a significant correlation between credit history evaluations and job performance. It is important for the analysis to also control for the position held by the employee, as well as other factors related to job performance such as seniority in the position, seniority within the company, educational attainment and prior experience.

Interpretation of Findings of Validation Studies

If job performance measures are significantly lower for candidates with weaker credit histories, this statistical evidence can be used to demonstrate to the EEOC that credit histories are valid selection criteria for these positions. Moreover, if the job performance gap is especially large, employers may consider being even more selective when hiring candidates with weak credit histories.

It is possible that a validation study will indicate that measured job performance does not vary significantly among candidates with strong and weak credit histories. In this case the employer should examine whether the absence of a correlation between credit histories and job performance is limited to some jobs or if this result is more pervasive. The absence of a significant correlation may be due to mitigating factors, so whenever possible mitigating factors should be accounted for in the analysis.

It is possible that the validation study has low power because few candidates with weak credit histories, regardless of race or gender, are hired. Regardless of the underlying explanation, statistical evidence will not persuade the EEOC that credit histories are valid selection criteria if measured job performance does not differ significantly by credit history.

Implications for Employers

The EEOC is concerned that the use of credit histories in hiring decisions may have an adverse impact on African-Americans, Latinos, women and persons with disabilities — and therefore, the commission is increasing its scrutiny of employers who include credit checks in their hiring process.

Given that different employers use various aspects of credit histories as hiring criteria for select positions, there are no large scale, peer-reviewed studies that can be used to provide compelling evidence that a good credit history should be a prerequisite for certain jobs.

Therefore, employers looking to limit their legal liability from credit histories should examine their applicant and personnel data to determine: 1) whether minorities appear less likely to receive job offers as a result of screening based on credit histories and 2) whether credit history evaluations are significantly correlated with subsequent job performance.

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