EMPLOYER USE OF CREDIT SCORES FOR SELECTION

Kristina Ambrusch, MSU Denver

ABSTRACT

The Fair Credit Reporting Act was enacted to remedy misuse of credit information. This regulated the use of credit information and provided consumers more rights and privacy. Given these consumer rights, employers must be cautious about using credit information for any employment decisions in order to remain in compliance with the Equal Employment Opportunity Commission (EEOC) regulations. These regulations require that all selection criteria be validated (proven that they predict job performance) and this validation has not been done with credit information. For this reason, credit information should not be used as selection criteria.

INTRODUCTION

Sixty percent (60%) of current employers include credit histories as part of their selection processes [10]. Since the inception of credit scores, Congress passed two laws to ensure their accuracy, fairness, and privacy for credit worthiness with respect to financial transactions [3], [6]. Because employers are now using them for selection, this raises a legal question: does the use of credit scores meet the EEOC's standards for selection instruments? Similarly, does their use create disparate impact for protected groups? To answer this question, this paper will review the history of credit scores, the EEOC's guidelines on selection specifically validity, discuss the ethical and social issues, and present the author's recommendations for employer use.

INTRODUCTION TO FAIR CREDIT REPORTING ACT

In order to protect people from having a bad credit score used against them, the government enacted the Fair Credit Reporting Act (FCRA). This act provides consumers accuracy, fairness and privacy when consumers' credit score are used by consumer agencies [9]; this includes credit and financial institutions. There are several rights that consumers have under this act. First, consumers must be notified when credit agencies run credit reports such as when individuals are applying for jobs, insurance, and credit cards. If the individual is denied, then the company has to give the individual the name and phone number for the agency that ran the report [9]. Secondly, citizens have the right to request their credit information for free once every year. Consumers can request this information from any one of the agencies and credit offices. Lastly, individuals have the right to dispute any wrong information on their credit reports.

In addition, this act requires credit agencies to fix or delete any incorrect information on credit reports and requires that the change be made within 30 days [9]. Secondly, credit agencies cannot report any information that is negative after seven years and they cannot report any bankruptcies that are 10 years or older [9]. Lastly, the agencies can only give out information if there is an actual need for the report. If any of the agencies violate the FCRA, they could be sued by the consumer. Also within this act, consumers have to give consent for whoever needs to run a report [9].

There were several issues that led to the creation of the FCRA. The FCRA was created in 1970 to encourage accuracy, privacy, and fairness concerning personal information coming from the credit reporting agencies [3]. In the late 1960's some credit report agencies abused the system by creating false information or not notifying individuals of incomplete or missing information. In addition, some agencies did lifestyle checks on individuals and transmitted reports to the public, without any consent from the individuals [3].

In 1970 Representative Leonor Sullivan and Senator William Proxmire were concerned with these issues and sponsored the law which took effect on April 25, 1971. Because this act was passed, many agencies had to redo their processes or they had to pay fines [3].

As recently as 2003, there have been some legislative additions to the FCRA. Within the FCRA, there is now FACTA (Fair and Accurate Credit Transactions Act). This blocks some of the privacy that individuals had but now allows individuals to request credit reports every year [3].

The Fair Accurate Credit Transactions Act was created to help protect account information of consumers against identity theft [6]. FACTA is enforced by numerous agencies including the Federal Trade Commission, National Credit Union Association, and other government agencies. One of the FACTA rules requires financial institutions to design and enforce an identity theft prevention program that will detect and prevent identity theft when consumers open certain accounts. Under FACTA, a financial institution is recognized as a state/national bank, mutual savings bank, state/federal credit unions, and organizations that hold an account that belongs to a consumer. These accounts include checking, savings, withdrawal accounts and other kinds of accounts. The main purpose of FACTA is that financial institutions have to do everything they can to prevent identity theft of the consumers they serve. Also with FACTA, consumers can put a stop on their credit report so that thieves cannot open new cards on their account. Lastly, FACTA requires that anyone who collects an individual's information has to shred it and or get rid of the information so that no one can take that person's information [6].

BACKGROUND ON EMPLOYMENT LAWS INCLUDING THE CIVIL RIGHTS ACT

Employer use of credit scores may violate employment law based on court cases and the Equal Employment Opportunity Commission's (EEOC) guidelines interpreting these laws. Specifically, employer use of credit may create disparate impact or not be valid (job related).

Disparate Impact

The usage of selection tests is common place within the business world for selection decisions. These selection tests can consist of instruments from personality tests to specific cognitive ability tests. In order to assure fairness and equality within these selection tests, the EEOC has set forth certain criteria that must be met in order for the test to be used legally to insure that no selection test has any negative impact on a protected class [5]. These guidelines include the 4/5 rule and validity. The usage of credit reports as a selection test has become an issue within the past decade due to the complexity of what can affect credit and whether credit reports truly have any correlation to foreseeing work performance and truly meet the criteria set forth by the EEOC.

Disparate impact occurs when a selection test appears to be fair, but in actuality has a negative disproportionate impact on a protected class. The 4/5 rule is a common way to insure that a selection test does not create disparate impact on a protected class. The 4/5 rule states that: a selection rate (i.e., passing rate) for any race, sex, or ethnic group which is less than 4/5th or 80% of the rate for the group with the highest selection rate is evidence of disparate impact [8]. A study done by the federal trade commission found use of credit scores has the potential to create disparate impact on minorities and women [7]. Another study tested the hypothesis that age, gender, and race are related to credit scores. This study found that that those factors account for 34% of the variance in credit scores among people. Whether or not one is a minority was found to be a significant factor in one's credit score; however gender was found to not be a significant factor. Age was determined to no be a legal issue for employers because people over 40 are part of a protected class, and also tend to have higher credit scores than individuals under that age [1].

Credit Score Validity

Test validity means that the employer's selection test can reasonably predict traits such as job performance or length of tenure. The burden is on employers to provide proof that their selection devices are valid. The three common justifications for employers using credit scores are 1) employees with serious financial problems are thought to be more likely to steal, and credit checks have traditionally been commonly used for positions in banks and other institutions where employees have access to financial accounts, and 2) that applicants' credit history is an indicator of their general conscientiousness and responsibility, and one that (unlike personality tests) is thought to be an objective behavioral record, and that credit reports verify employment history (and keeps applicants from hiding criminal convictions) and background information [7].

Ideally, an employer would know as much about the applicant before hiring the individual, but the credit report provides limited useful information in the hiring process. A credit report is one tool that the Society for Human Resource Management reports is used by 60% of employers in order to prevent financial related criminal activity, liability for negligent hiring, and to determine a candidate's trustworthiness [10]. A credit report can serve to verify previous addresses and employers. By knowing previous addresses, employers are able to check for criminal history in those areas. Debt and payment history is also included, yet the actual credit score is not, nor is the person's date of birth [7]. The lack of date of birth prevents any sort of age discrimination, and not having the credit score included prevents the employer from doing side by side comparisons of the candidate's numeric credit scores. Yet, there is some subjectivity in the judgment of the part of the employer because the employer is left to judge the amount of debt a person has and determine what is "good" or "bad."

The subjectivity in the judgment of the credit report can partially be attributed to the fact that there is little research available on the validity and job relatedness of using credit scores as a selection test. This lack of information directly linking job performance and credit scores presents an issue concerning its validity of the use. There have been studies linking personality assessments and job performance, so there was a research study done to determine if there is a link between credit scores and the Big Five personality traits and to work performance [2]. This study was conducted at several universities in the South and looked at credit scores in relation to

task performance, organizational citizenship behavior, and workplace deviance; as well as the link between credit scores and the Big Five. The study concluded there was no evidence to support the claim that credit scores validly predict performance. However, there is a small positive relationship between conscientiousness and credit score, and there is a small negative relationship between agreeableness and credit scores [2]. Although there are these small relationships, they do not meet the EEOC's requirement that relationships be significant. The fact that there is limited information available linking credit scores and performance and the inability to fully link credit scores to this personality assessment presents a problem for employers, in terms of proving validity for the reasons employers cite for using credit scores.

Court Cases on Employer Use of Credit Scores

There has only been one case of on employee use of credit scores and its ruling leaves many unanswered questions. In the case of Terry vs. Electronic Data Systems, Terry was an African American temporary employee for Electronic Data Systems. When Terry came up for a promotion to a full time employee he was passed up because of an unfavorable credit report. His credit score was damaged because of outstanding debt from school loans. Summary judgment was granted for Electronic Data Systems even though the court stated that credit history was not a factor in job performance [7]. One can argue that using a credit score as criteria for a an employee that has already proven his worth so much that the company decided to make him a full time employee is completely unnecessary and holds little credibility in predicting future job performance.

ETHICAL / SOCIAL CONSIDERATION

In today's increasingly competitive business environment it is crucial for large companies to be viewed publicly as ethically and socially responsible. Social responsibility can be a competitive advantage for a company, and can almost be considered a requirement for certain types of businesses, such as large corporations that compete within the same industry. Negative publicity regarding a company's ethical or social responsibilities within a community, such as unfair employment consideration practices, can have a significant impact on the company's reputation and sales.

The FCRA has eliminated many of the unfair credit reporting practices of the past some issues, however employers using credit scores as a deciding factor of employment, remains legal by the current provisions of this law [5]. High profile scandals in corporate America have caused more and more employers to increase the amount of background and credit checks on potential employees [5]. Recent surveys indicate that 60% of companies use credit checks for employment selection and every employee from the CEO to the janitors are subject to the screenings [5]. A study from the Public Interest Research Group in 1998 found that 29% of credit reports contained errors that have the potential for denial of credit [5].

Using credit reports for employment decisions can be viewed as unethical because the information in the reports seldom pertains to the job. Someone who suffers an unfortunate medical crisis or a person who is laid off and faces temporary unemployment may be discriminated against for a job because of one event that affected their credit that was truly out of

their control [5]. Doing so is an unnecessary invasion of the potential employee's privacy and leads to racial-minority discrimination and discrimination against individuals who experienced isolated misfortunate events [5]. Several states have limited the use of employment credit reports arguing the potential benefits are negligible and fail to predict the quality of a potential employee as well as such uses have the potential of desperate impact on a protected class [4].

CONCLUSION / RECOMMENDATION

The authors' opinion is that credit scores were never intended to be used in selection because they: introduce subjectivity into hiring decisions, lack statistical proof that credit scores are related to performance, reveal information that employers should not be able to access, create adverse impact on protected groups, and raise ethical issues. Therefore, Congress should add provisions to the FCRA limiting employer's right to use credit history in making employment decisions for all but certain classes of employees such as those involved in finance or accounting [5]. Also Congress should employ a commission to review complaints involving all background checks for employment decisions [5]. Based on the lack of validity, as set forth by the EEOC regulations, the use of credit information as a selection tool is not a legal practice for employers therefore the actions recommend any employers who are using credit information as a selection tool should cease immediately. The only acceptable use of credit information in the selection process is for verification for previous address and employers.

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