

## Employers running credit checks on job applicants must tread carefully

Increasingly unpopular, background checks are restricted by state, federal laws

By [Beth Braverman](/credit-card-news/authors/beth-braverman.php) | Published: July 25, 2016



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In addition to checking references and conducting interviews, one potential tool for evaluating the worthiness of a job candidate is performing a credit check.

A 2012 survey (<https://www.shrm.org/research/surveyfindings/articles/pages/creditbackgroundchecks.aspx>) by the Society for Human Resource Management (SHRM) found that nearly half of organizations run credit background checks on job candidates. Among companies that did perform them, 45 percent said they did so to decrease or prevent theft and embezzlement, and 22 percent wanted to reduce their legal liability for negligent hiring. That study, the most recent one available, showed a decline in the number of employers using credit checks for hiring decisions.

That could be due to increasing scrutiny from both legislators and consumer activists over the practice, particularly in the wake of the Great Recession, which left scars on the credit reports of many Americans who otherwise handled credit well. In addition, [more than half of all unpaid bills in collection are medical debts](http://www.creditcards.com/credit-card-news/cfpb-medical-debt-1282.php) (<http://www.creditcards.com/credit-card-news/cfpb-medical-debt-1282.php>), which regulators are increasingly advising should be treated differently from other debts.

"Twenty years ago, a credit check may have been a better verification of whether a person was responsible or could handle money well," says Tom Armour, co-founder of High Return Selection, a company that teaches businesses how to improve their hiring processes. "Today, such a large slice of the population is challenged financially, you can't apply the same rules. Recent grads have massive debt; people had housing problems in the bust."

Critics claim that a person's credit is irrelevant to his ability to perform a job, and that employment credit checks limit upward mobility and exacerbate racial discrimination. Three-quarters of low- and middle-income workers with credit card debt who were [surveyed by policy research group Demos](http://www.demos.org/discredited-how-employment-credit-checks-keep-qualified-workers-out-job) (<http://www.demos.org/discredited-how-employment-credit-checks-keep-qualified-workers-out-job>) in 2012 said that employers shouldn't have access to a job applicant's credit report.

Doing background credit checks improperly can be a big liability. In 2015, Whole Foods [paid out more than \\$800,000](http://topclassactions.com/lawsuit-settlements/lawsuit-news/161350-whole-foods-settles-background-check-class-action-lawsuit-for-803k/) (<http://topclassactions.com/lawsuit-settlements/lawsuit-news/161350-whole-foods-settles-background-check-class-action-lawsuit-for-803k/>) to settle a class action lawsuit alleging that it didn't properly disclose to potential employees that the company was running background checks on them.

If you're considering running a credit check on job applicants, follow these steps:

**1. Find out whether there are restrictions in your state.** Eleven states ([see chart](#)) have placed restrictions on employers' ability to use background credit checks in employment screening, including limits on which, if any, industries or job functions are eligible to use them. Another 10 states are considering similar laws, according to the National Council on State Legislatures. Cities such as New York and Chicago also regulate employment credit checks.

"Because it's a dynamic landscape with a lot of changing regulation and new developments every year, you need to make sure you're working with the latest information," says Bruce McClary, a spokesman with the National Foundation for Credit Counseling. "If there's any doubt, check in with your state's attorney general's office."

U.S. Senator Elizabeth Warren has also introduced a bill, the Equal Employment for All Act, which would increase the federal restrictions on employer credit checks.

**2. Use them sparingly.** Given the cost of running credit checks on applicants and the potential for legal issues, you probably won't want to run them on everyone who wants to work for your company. They make much more sense for some jobs than others. For example, in states with restrictions in place, there may be exemptions for certain occupations, such as those in the financial industry or for executives with fiscal responsibilities to their employer or clients.

Timing is important, too. A credit screen usually makes the most sense in the last stages of the hiring process, when you're trying to make a final decision between two candidates or want to confirm your likely choice. The SHRM report founds that among companies that use background checks, 58 percent conduct them after making a contingent job offer, and 33 percent initiate them after an interview.

However you use credit checks, be consistent. Run them on all applicants for a specific position (or none) at the same point in the process to avoid any appearance of discrimination.

**3. Inform the applicant you're running the background credit check.** Even if your state doesn't have any regulations regarding background credit checks, you'll still need to follow the [guidelines](https://www.ftc.gov/tips-advice/business-center/guidance/using-consumer-reports-what-employers-need-know) (<https://www.ftc.gov/tips-advice/business-center/guidance/using-consumer-reports-what-employers-need-know>) set forth in the Fair Credit Reporting Act and enforced by the Federal Trade Commission.

You must provide the candidate written notice that you'll be requesting a credit report, and get written permission from the applicant to do so. You'll need to show the notification and authorization to the credit bureau that's pulling the report and confirm that you won't use any information in the report to illegally discriminate against the potential employee.

**4. Consider the report carefully.** Unlike the credit reports pulled by a lender, you won't get a score for your candidate, but a rundown of their credit history, including current and past debts on everything from student loans and mortgages to tax liens. You'll also see any late payments, current or former bankruptcies, and the applicant's debt-to-income ratio.

Proponents of credit checks say that workers with poor credit may be more susceptible to blackmail or could be more likely to commit fraud, though there is no research to support such claims. Evaluate the candidate's report for patterns, rather than drawing conclusions based on any single factor. "The report usually won't give you a black-and-white answer

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— Tom Armour  
Co-founder, High Return Selection

about whether to hire someone,” Armour says.

In most cases, even a report that does raise red flags should not automatically nix a good candidate. Eight in 10 companies surveyed by SHRM said that they have hired a job candidate with negative information in a credit report. Possible reasons are that the reports don't provide context for the subject's financial decisions, and credit reports are notoriously riddled with errors. A 2013 report by the FTC found that 1 in 5 consumers had an error on a credit report (<http://www.creditcards.com/credit-card-news/ftc-credit-report-mistakes-1270.php>).

**5. If the findings are affecting your decision, discuss them with the applicant.** Under federal law, if you decide not to hire a person based on information in their credit report, you must provide them with a copy of the report as well as a copy of A Summary of Your Rights Under the Fair Credit Reporting Act (<https://www.consumer.ftc.gov/sites/default/files/articles/pdf/pdf-0096-fair-credit-reporting-act.pdf>). You must also provide contact information for the company that provided the report, so that the consumer can dispute any incorrect information.

This also gives the applicant a chance to explain the circumstances around any issues found in the report. It's possible that the report is based on incorrect information, or that extenuating circumstances like a job loss, divorce, or medical issues mean that the financial problems may not be a true reflection of the applicant. “All a credit report can tell you is that a person didn't pay their bills,” says Lewis Maltby, president of the National Workrights Institute. “It doesn't say why.”

**6. Properly dispose of the report.** It's your responsibility to protect job applicant's privacy and identity. Under FTC guidelines (<https://www.ftc.gov/tips-advice/business-center/guidance/disposing-consumer-report-information-rule-tells-how>), that means you must burn, pulverize or shred any documents with the consumers' information and destroy any electronic files containing the same.

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— Lewis Maltby  
President, National Workrights Institute

STATES WITH LAWS RESTRICTING EMPLOYER CREDIT CHECKS	
State	Restrictions?
Alabama	No
Alaska	No
Arizona	Pending
Arkansas	No
California	Yes
Colorado	Yes
Connecticut	Yes
Delaware	Yes
District of Columbia	Pending
Florida	No
Georgia	No
Hawaii	Yes
Idaho	No
Illinois	Yes
Indiana	No
Iowa	No
Kansas	No
Kentucky	Pending
Louisiana	No
Maine	No
Maryland	Yes
Massachusetts	Pending
Michigan	Pending
Minnesota	No
Mississippi	No
Missouri	Pending
Montana	No
Nebraska	No

Nevada	Yes
New Hampshire	No
New Jersey	Pending
New Mexico	No
New York	Pending
North Carolina	No
North Dakota	No
Ohio	Pending
Oklahoma	No
Oregon	Yes
Pennsylvania	Pending
Rhode Island	No
South Carolina	Pending
South Dakota	No
Tennessee	No
Texas	No
Utah	No
Vermont	Yes
Virginia	No
Washington	Yes
West Virginia	No
Wisconsin	No
Wyoming	No

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