Dēmos

DISCREDITING WORKERS

How Credit Reports are Distorting the Job Market, Prolonging Unemployment, and Denying Equal Opportunity to Workers

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About Demos

Dēmos is a non-partisan public policy research and advocacy organization. Headquartered in New York City, Dēmos works with advocates and policymakers around the country in pursuit of four overarching goals: a more equitable economy; a vibrant and inclusive democracy; an empowered public sector that works for the common good; and responsible U.S. engagement in an interdependent world.

Dēmos was founded in 2000

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Introduction

Economic insecurity has become the "new normal" in America. Ten million Americans are out of work, and the vast majority of Americans have seen their incomes stagnate or decline over the past decade. Demos' extensive research on credit card debt among middle- and low-income households has found that most indebted families go into debt to pay for basic expenses: groceries, utilities, child care, and health care.[1] Simply put, Americans are borrowing to make ends meet. Credit card companies' own practices have exacerbated the problem, with well-documented abuses that increase fees, rates and penalties—making it even harder for the average American family to keep a blemishless credit history.

Against this backdrop of troubled family finances, there has been a dramatic increase in the marketing and use of consumer credit reports for a purpose completely unrelated to extending credit: employer decisions to hire or fire workers.[2] Employer surveys conducted by the Society of Human Resources Management (SHRM) suggest that over the last 15 years, employers' use of credit reports in hiring processes has gone from being a marginal practice, one used by less than one in five employers in 1996, to a commonplace one used by 6 out of every 10 employers in 2009.[3]

This increase in employers' use of credit-history information to make hiring and firing decisions comes despite strong evidence that credit checks have no validity in predicting job performance, and warnings from the Equal Employment Opportunity Commission that the practice results in discriminatory hiring and

KEY POINTS

- A majority of employers now use credit reports to make some or all hiring decisions.
- Rigorous social science research shows that negative information in credit reports has no correlation to job performance.
- A TransUnion representative acknowledged earlier this year they "... don't have any research to show any statistical correlation between what's in somebody's credit report and their job performance or their likelihood to commit fraud."
- The use of credit checks produces discriminatory hiring and firing decisions that deny equal opportunity to workers.
- Because so many credit reports include erroneous information, even workers who have paid all their bills on time can be harmed by employers' use of credit reports.
- Congress should protect job seekers and employees by prohibiting employers from forcing them to disclose credit information to obtain or retain employment.

firing decisions that violate civil rights and deny equal opportunity to workers. If America is the "land of the second chance" and committed to equal opportunity, it's hard to think of a practice that flies more in the face of this than letting employers deny jobs to people on the basis of their credit history. Congress should act now to end the unfair and arbitrary use of credit reports to make hiring and firing decisions. Especially in today's economy—with a nearly 10 percent unemployment rate and a doubling over the last four years in the share of outstanding debt balances that are delinquent—the stakes for American workers are too high to allow employers to outsource hiring decisions to credit reporting agencies. The following brief addresses key myths that industry representatives have perpetuated in support of this practice and recommends a federal ban on inappropriate uses of credit reports in employment decisions.

Myth #1: Credit History Predicts Job Performance

The one rigorous study of credit checks for employment purposes conducted to date found that credit history information does not measure job requirements in a fair and reliable way. In this study, conducted at the request of and funded by a large employer, Professors Jerry Palmer and Laura Koppes of Eastern Kentucky University sampled 178 employees holding "financial services and collections" jobs.[4] The sample included 108 active employees and 70 terminated employees.

Palmer and Koppes compared each of the specific categories of credit information in the employees' credit reports—for example, the number of past-due accounts--with performance ratings (of the active employees) and termination data. If credit report data predicted employee performance, the performance ratings of employees with poor credit should have been lower than the performance ratings of employees with better credit. Similarly, one would expect employees who were fired to have poorer credit than active employees.

> "... we don't have any research to show any statistical correlation between what's in somebody's credit report and their job performance or their likelihood to commit fraud."
>
> -Eric Rosenberg, TransUnion

Palmer and Koppes found no evidence of this. For active employees, none of the categories of credit information were associated with employees' job performance ratings in the expected way. Only one of the categories— the number of times

payments were 30 days late—had a statistically significant correlation with performance, but the correlation was exactly the opposite of what was expected. Higher levels of being 30-days late on a payment were associated with more positive job performance ratings rather than more negatives ones. This makes intuitive sense: a person who is facing financial pressures has an even greater incentive to perform well at work to keep their job and merit a salary increase or even a promotion. Additionally, none of the categories of credit reporting data had a statistically significant association with termination. In other words, the credit of terminated employees was no worse than that of active employees.

Some representatives of credit reporting agencies have acknowledged the lack of evidence showing a relationship between credit-report data and job performance. Most notably, Eric Rosenberg, TransUnion's Director of State Governmental Relations, acknowledged earlier this year that: "... we don't have any research to show any statistical correlation between what's in somebody's credit report and their job performance or their likelihood to commit fraud."[5]

Myth #2: Credit History Predicts Employee Fraud

The second common myth is that screening out workers with weak credit is necessary to prevent employee fraud. In testimony before Congress earlier this year, Stuart K. Pratt, the president and CEO of the Consumer Data Industry Association, a lobbying association that represents the interests of the "big-three"credit reporting agencies—TransUnion, Experian, and Equifax—claimed that credit-report information "shows a correlation between past behavior and future fraud."[6] In support of this claim he cited a 2008 survey conducted by the Association of Certified Fraud Examines (ACFE).[7] This study was based on data compiled from 959 cases of occupational fraud investigated in 2006 and 2007. In about one-third of these cases, investigators reported that the person committing the fraud was experiencing "financial difficulty" at the time of the fraud or "living beyond their means."

However, the ACFE report is not a reliable validation study. The ACFE data provides no evidence that credit checks have any validity in predicting employee fraud, or that, as Pratt claimed, prohibiting the use of credit reports for employment purposes would "undercut fraud prevention." Unlike the Palmer-Koppes study, the ACFE study does not use a random sample methodology or

objective indicators. The ACFE data came from an online survey distributed to fraud examiners who were asked to provide a narrative of the "single largest fraud case" they had investigated in which the investigation was complete and the examiner was "reasonably sure" the perpetrator had been identified. ACFE received usable responses from only 5.8 percent of the investigators that it sent the survey to. Thus, the survey is not representative of employee fraud in general or even of large-scale occupational fraud.[8]

While the Palmer-Koppes study directly tests the link between data in credit reports and job performance, the ACFE provides no test of this linkage because it doesn't draw in any way on data in the credit reports of those employees believed by investigators to have committed fraud. Instead, investigators were simply asked to check boxes on a list of fairly general and often vague behaviors that the investigator believed to be present during the period the fraud was committed. There is no indication that credit reports of the alleged perpetrators included information that indicated they were either experiencing "financial difficulty" or "living beyond their means."

Myth #3: Credit Report Screening is a Fair, Nondiscriminatory Employment Practice

Because of inequitable practices in America's lending market – credit discrimination, community redlining, and most recently, predatory lending – the effects of credit report screening are predictably racially disparate. Economic insecurity is even more pronounced for African Americans and Latinos, who have less household wealth and lower wages to tap to meet unexpected expenses. Furthermore, Demos' research has shown that they pay higher interest rates on credit cards than do white Americans (making debt more expensive and harder to pay off) and are more likely to have been called by a bill collector.[14]

Earlier this year, the U.S. government won a case brought by the Office of Federal Contract Compliance Programs, in which Bank of America was found to have discriminated against African-Americans by using credit checks to hire entry-level teller, clerical and administrative positions.[9] The percentage of candidates excluded because of a credit check was significantly higher for African Americans (11.5 percent) than for whites (6.6 percent). Generally, civil rights law requires employers to justify the appropriateness of an employment practice if it creates such a disparate impact on a group historically subject to job discrimination.

Despite the clear disparate impact of the policy on African-Americans, Bank of America had conducted no study to determine whether credit reports were actually a predictor of job performance, and had not investigated the issue. An expert cited in the court's decision found the bank's review of credit reports to be "highly subjective, with no specifications about what thresholds had to be met for what indicators."[10] The judge concluded that "there was no evidence of any criteria used by the recruiters" in using the credit report information to disqualify applicants."[11] In the end, the bank was unable to offer evidence supporting its main justification for the practice: that credit reports were required for surety or bonding purposes.[12] Americans of color have comparatively weak credit profiles due in large part to public policies and lending industry practices; Congress should no longer allow a new set of policies and practices to unnecessarily block them from employment opportunities as a result.

Myth #4: Credit Reports are Accurate Representations of Financial History that Employers Can Rely On In Making Hiring Decisions

Given the widespread reliance on credit reports for life-determinative decisions, a threshold requirement should be that the reports are accurate and reliable depictions of financial history. Yet, research shows that credit-reporting agencies commonly include incorrect information in credit reports. For example, as cited in the most recent Federal Trade Commission (FTC) report on the accuracy of credit reports, over 40 percent of people who had reviewed their credit files reported errors that they wanted to dispute.[13] The FTC report also provides evidence that individuals with lower credit scores are much more likely to find errors after reviewing their report. In particular, material errors were alleged in half of cases with a credit score under 610 and one-third of cases with a score between 610-689.

Conclusion

Job selection procedures and criteria that are not job-related are not in the interests of either employers or potential employees. For employers, the use of such procedures impose costs without proving any benefits and will have the effect of screening out candidates who could have been considered the best qualified for the job if the hiring process had been limited to job-related considerations. For potential employees, the use of non-job-related criteria means that the denial of employment is due not to their actual abilities and qualifications for the job.

Potential and current employees should not be compelled to authorize disclosure of data in their credit reports in order to obtain or retain employment. If, at some point, social-science consensus develops, based on rigorous empirical evidence, that a specific category or categories of credit information is predictive of occupational fraud in particular job categories, a limited exception to this general rule should be considered that allows employers to access those specific categories of credit information, but not to base hiring or firing decisions on credit-report information alone.

Endnotes

1. Tamara Draut and Jose Garcia, "The Plastic Safety Net: How Households are Coping in a Fragile Economy", Demos 2009, available at: http://demos.org/publication.cfm currentpublicationID=C1B896F4-3FF4-6C82-56F2B3EF557CCFF5

2. See, e.g., Ben Arnoldy, The Spread of the Credit Check as Civil Rights Issue, The Christian Science Monitor, January 18, 2007; Thomas Frank, When 'Bad' Credit Stands in the Way of a Good Job, USA Today, February 21, 2009; Jonathan D. Glater, Another Hurdle for the Jobless: Credit Inquiries, N.Y. Times, August 7, 2009; Andrew Martin, As a Hiring Filter, Credit Checks Draw Questions, N.Y. Times, April 9, 2010.

3. Society of Human Resources Management, Background Checking: Conducting Credit Background Checks, January 22, 2010.

4. Jerry K. Palmer and Laura L. Koppes, Investigation of Credit History Validity at Predicting Performance and Turnover, paper presented at meeting of Society for Industrial and Organizational Psychology, Chicago, Illinois, April 3, 2004.

5. Andrew Martin, As a Hiring Filter, Credit Checks Draw Questions, N.Y. Times, April 9, 2010.

6. Testimony of Stuart K. Pratt, Consumer Data Industry Association, before the House Subcommittee on Financial Institutions and Consumer Credit, May 12, 2010.

7. Association of Certified Fraud Examiners, 2008 Report to the Nation on Occupational Fraud and Abuse.

8. In his written Congressional testimony, Pratt cites the median loss data from the report in a misleading way that suggests it is representative of occupational fraud generally and not just a non-representative sample of the "single largest fraud case" investigated by each respondent to the survey.

9. In the Matter of: Office of Federal Contract Compliance Programs, United States Department of Labor v. Bank of America, Recommended Decision and Order, Case No.: 1997-OFC-16, January 21, 2010. The case involved discrimination alleged to have occurred in 1993 and between 2002 and 2005. Credit checks were used by the bank in 1993, but discontinued.

10. Id. at p. 25.

11. Id. at p. 49, emphasis in original.

12. The judge concluded that there was "simply nothing in the record that even tends to show that an acceptable credit

13. About 11 percent of people in the study reported errors that were categorized as "material" ones. However, material was defined in a way that limited it to individuals with credit score below 760. Thus, errors that were material for someone with a score under 760 were treated as non-material for those with scores above 760. This limited definition of materiality likely excludes errors that are material in the employment context. In employment context, unlike the lending context, it is the specific pieces of information in the report, and not credit scores (which generally are not available to employees), that can have an adverse impact. Thus, even for employees with scores above 760, a single error in a credit report could result in denial of a job offer.

14. Demos, "The Color of Debt Fact Sheet," September, 2009 available at: http://www.demos.org/pubs/TheColorofDebt-FactSheet.pdf

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