white paper

BACKGROUND SCREENING IN THE FINANCIAL SERVICES INDUSTRY

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As the regulation of employment practices in general—and financial services in particular—continues to grow and become increasingly complex, firms operating in this industry are faced with the challenge of determining how best to comply with varying legal requirements that at times seem to be in direct conflict with each other. Statutory and regulatory requirements on the federal level may require institutions to engage in certain practices that are generally prohibited by state or local laws aimed at decreasing discrimination in employment.

This White Paper will first provide an overview of the major background screening and investigation requirements that apply to firms operating in the financial services industry. Then it will highlight some of the potential issues that can arise for employers due to the growing number of anti-discrimination laws being enacted in local jurisdictions, including restrictions on using criminal records and credit history information in employment decisions.

1. Background Screening and Investigation Requirements in Financial Services

Employers in the financial services industry, such as insurance companies, banks, credit unions and broker-dealers, are subject to various background investigation and screening requirements. The following section provides an overview of the major

screening and investigation laws and regulations that apply to these institutions.

A. Insurance Companies

Insurance producers and insurance companies are regulated by the Violent Crime Control Act as well as by the various state laws and requirements set by state insurance departments.

Under 18 U.S.C. § 1033(e) of the Violent Crime Control and Law Enforcement Act of 1994 (VCCA),[1] individuals who have been convicted of a felony crime involving dishonesty or breach of trust are prohibited from working in the insurance industry unless they obtain written consent from their state insurance commissioner. This section also goes a step further by making it unlawful for any person to willfully permit an individual with such a felony conviction to engage in the business of insurance, thus requiring "insurance companies, reinsurers, agents and all other types of entities engaged or participating in the business of insurance as defined in these federal statutes to attempt to identify if any present employees or prospective employees have been convicted of any such felonies."[2]

"It is essential to any determination as to whether or not a criminal offense contains an element of dishonesty or breach of trust to include a review of the criminal statute in question and the specific elements of that crime. Only through a thorough review of the statutory elements of a particular crime can a determination be made whether or not the crime would trigger the prohibitions contained in Sec. 1033."[3]

The criminal enforcement of § 1033(e) is the responsibility of the federal government. However, state insurance commissioners and agencies continue to have authority to regulate the insurance industry in their states, including overseeing §1033(e) waiver requests and determining whether

[1] Public Law 103-322, H.R. 3355.

[2] *Guidelines for State Insurance Regulators to the Violent Crime Control and Law Enforcement Act of 1994: United States Code §§ 1033 – 1034*, National Association of Insurance Commissioners 8 (2011), *available at* http://www.naic.org/documents/prod_serv_legal_sir_op.pdf.

[3] *Id.* at 34. Additional guidance on what crimes involve dishonesty or a breach of trust can be obtained from the NAIC's Guidelines for State Insurance Regulators *available here*: http://www.naic.org/documents/prod_serv_legal_sir_op.pdf. Additional guidance on crimes involving dishonesty or a breach of trust can be obtained from the Federal Deposit Insurance Corporation's statement of policy for Section 19 of the Federal Deposit Insurance Act *available here*: https://www.fdic.gov/regulations/laws/federal/98sop19.pdf. This provides the FDIC's positions on interpreting a federal law which contain elements similar to 18 U.S.C. §§ 1033 and 1034.

or not to grant such waivers.[4] "A written consent granted by an insurance commissioner under the [VCCA] merely releases the holder of the consent from his or her status as a 'prohibited person' under federal law. Whether the holder of the consent is qualified to engage in the business of insurance then becomes entirely a matter of state law, just as it would have been in the absence of 18 U.S.C. § 1033."[5]

This is noteworthy because "many states also have laws limiting the ability of certain persons with criminal records to engage in the business of insurance. … [T]hese laws operate independently from 18 U.S.C. § 1033 and are not preempted or in any way modified by Sec. 1033."[6] Often, these state laws will differ in significant ways. For example, "the state law prohibition might be triggered by a different list of crimes, might only last for a certain number of years, or might apply only to activities requiring a license. Thus, someone might be barred by 18 U.S.C. § 1033 but not by a similar state law, or vice versa."[7]

Additionally, some states may impose additional investigation requirements, such as requiring insurance companies to reaffirm a producer's background and fitness to continue to act as an agent for the company when applying to renew that producer's appointment each year.[8] These requirements are completely separate from any federal requirements under 18 U.S.C. § 1033.

B. Banks and Federally Insured Institutions

Section 19 of the Federal Deposit Insurance Act (FDIA)[9] and Section 205(d) of the Federal Credit Union Act (FCUA)[10] govern whether an individual may be employed by a federally insured depository institution or an insured credit union, respectively. These institutions are prohibited from employing any person who has been convicted of any criminal offense involving dishonesty or breach of trust, including money

[4] *Id.* at 1.

[5] *Id.* at 8.

[6] *Id.*

[7] *Id.*

[8] Arkansas requires every licensed entity which appoints an insurance producer in the state to annually file with the Insurance Commissioner a renewal appointment under the Producer License Model Act (Ark. Code Ann. § 23-64-219 and § 23-64-514(b)). The insurance company's renewal of a producer's appointment indicates that the appointing company has reviewed the producer's background and fitness to continue to act as an agent of the company. *See 2012 Company Appointment Renewals for* Producers, Arkansas Insurance Department (March 4, 2013), *available at* http://www.insurance.arkansas.gov/Legal/Bulletins/2-2012.pdf.

[9] 12 U.S.C. § 1829.

[10] 12 U.S.C § 1785.

laundering or any criminal offense concerning the illegal manufacture, sale or distribution of or trafficking in controlled substances. This would include any person who has agreed to enter into a pretrial diversion or similar program in connection with a prosecution for any such offense.[11] If a federally insured institution wants to employ a person who was convicted of a prohibited offense or entered a pretrial diversion program for such an offense, it has to seek a waiver from the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Administration (NCUA).

Unfortunately for employers, there is currently no comprehensive list of all crimes that bar employment under these sections or that would require an application for a waiver and the express written consent of the FDIC or NCUA. "Whether a crime involves dishonesty or a breach of trust should be determined based on the statutory elements of the crime."[12]

Generally, "dishonesty" means to directly or indirectly: "cheat or defraud, cheat or defraud for monetary gain or its equivalent, or to wrongfully take property belonging to another in violation of any criminal statute."[13]

"Dishonesty" also includes "acts involving want of integrity, lack of probity, or a disposition to distort, cheat, or act deceitfully or fraudulently, and may include crimes which federal, state or local laws define as dishonest."[14]

"Breach of trust" generally refers to a "wrongful act, use, misappropriation or omission with respect to any property or fund that has been committed to a person in a fiduciary or official capacity" or the "misuse of one's official or fiduciary position to engage in a wrongful act, use, misappropriation or omission."[15]

Despite the absence of a comprehensive list of all prohibited offenses, all convictions for offenses concerning the illegal manufacture, sale, distribution of or trafficking in controlled substances require an application for a regulatory waiver.[16] Further, individuals convicted of certain financial crimes are subject to an outright prohibition of working in (or owning or controlling) an insured depository institution or credit union for 10 years. These crimes include: receipt of commissions or gifts for procuring loans; theft, embezzlement or misapplication by bank officer or employee; filing or making false/misleading bank entries, reports and transactions; filing or making false/misleading federal credit institution entries, reports and transactions; concealment of assets from conservator, receiver or liquidating agent of financial institution; bank fraud; obstructing examination of financial institution; laundering of monetary instruments; engaging in monetary transactions in property derived from specified unlawful activity; frauds and swindles; and fraud by wire, radio or television.[17]

Institutions are required to perform a "reasonable inquiry" regarding an applicant's history to avoid hiring or permitting participation by a person with a covered conviction, but no guidance is provided on

[11] *Id.*

[12] Jennifer L. Mora & Jonathan Shapiro, *Background Screening in the Financial Services Industry*, LITTLER MENDELSON P.C. 9 (Mar. 3, 2016), *available at* https://www.littler.com/events/background-screening-financial-services-industry [hereinafter referred to as "LITTLER MENDELSON"].

[13] *Id. at 7.*

[14] *Id.*

[15] *Id.*

[16] Federal Deposit Insurance Corporation, Application Pursuant to Section 19 of the Federal Deposit Insurance Act 5 (Feb. 28, 2017), *available at* https://www.fdic.gov/formsdocuments/6710-07.pdf.

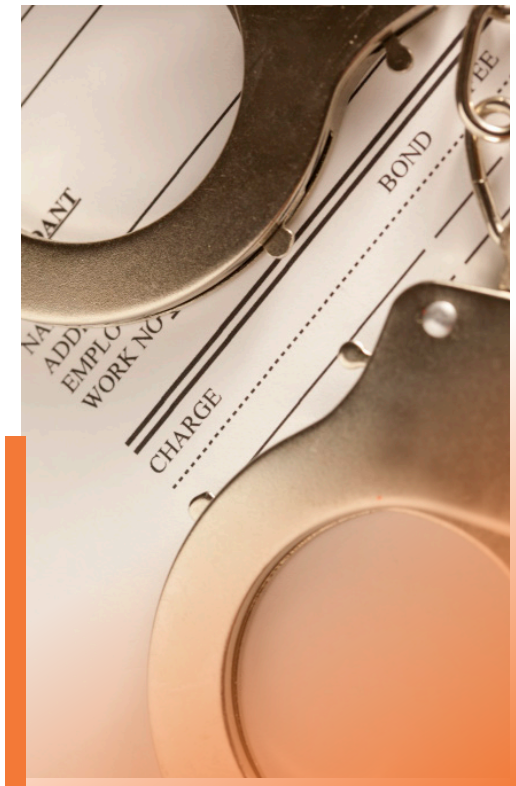
[17] See 12 U.S.C. § 1829(2).

what constitutes a "reasonable inquiry." Institutions should, at a minimum, establish a screening process that can produce all relevant information regarding convictions (or diversion program entry) pertaining to a job applicant.[18] According to a statement of policy issued by the FDIC,[19] this would include, for example, "completion of a written employment application that requires a listing of all convictions and diversion program entries."[20]

Nonetheless, "neither FDIC nor NCUA guidance states that a criminal background check is mandatory."[21] Notwithstanding, "criminal background checks may serve as evidence of a reasonable inquiry. If there is a violation, regulators will look to the circumstances of the situation to determine whether the inquiry was reasonable. Among the suggested measures that institutions can take are an FBI fingerprint search and a third-party background check."[22]

It is important to note that not all employees may be covered by the aforementioned laws. Section 19 applies *only* to FDIC-insured institutions, their institution-affiliated parties and those participating in the affairs of an insured depository institution. While all employees of an insured depository institution fall within the scope of Section 19, it is not clear whether the same is true for "de facto employees" such as contractors and consultants. "Applying Section 19 to non-bank employees creates an unprotected gap between Section 19's actual coverage and exemptions, and defenses available under federal, state and local anti-discrimination laws."[23]

Further, not all criminal convictions are "covered offenses." A conviction or program entry that is considered *de minimis*[24] or is otherwise not a "covered offense," does not provide a safe harbor from other antidiscrimination laws if it is used as the basis on which to refuse to hire an applicant, because Section 19 would not bar the individual's hire.[25]



[18] Littler Mendelson, *supra* note 12, at 10.

[19] 63 Federal Register 230, 66177, *available at* https://www.fdic.gov/regulations/laws/federal/98sop19.pdf.

[20] Littler Mendelson, *supra* note 12, at 10. If an insured depository institution determines that a "covered person" needs to apply to the FDIC for written permission to become an institution affiliated party or participate in the affairs of an insured depository institution, there are two methods for doing so. The first method involves an insured depository institution filing a Section 19 application on behalf of a prospective director, officer, or employee (Sponsorship). If an insured depository institution refuses to file a Section 19 application on behalf of a covered person, a second method allows that individual to seek a waiver of the requirement that an insured depository institution file a Section 19 application on his or he behalf (Individual Waiver). More information on this process is available here.

[21] *Id.* at 11.

[22] *Id.*

[23] *Id.* at 14.

[24] Consent is automatically granted and no waiver application is required where the covered offense is considered *de minimis*. "A covered offense is considered *de minimis* if it meets all of the following requirements: 1) only one conviction or pretrial diversion program entry for a covered offense; 2) offense was punishable by imprisonment for a term of one year or less and/or a fine of $2,500 or less ($1,000 under the NCUA rules) and the individual served three days or less of actual jail time (no period of incarceration under the NCUA rules); 3) conviction or program entry was at least five years before; and 4) offense did not involve an insured depository institution or credit union." *Id* at 13. Additional information on what constitutes a *"de minimis"* offense is available here.

[25] Littler Mendelson, *supra* note 12, at 15.

C. Loan Originators

The Secure and Fair Enforcement for Mortgage Licensing Act and Regulation Z of the Truth in Lending Act set forth the background investigation requirements for loan originators.

The Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (the "SAFE Act") applies to "covered financial institutions" including national and state banks, branches of foreign bank, insured credit unions and other financial institutions, and requires that "mortgage loan originators"[26] who originate residential mortgage loans obtain the appropriate state license or Federal registration. Mortgage loan originators who work for an insured depository institution or its owned or controlled subsidiary that is regulated by a federal banking agency, or for an institution regulated by the Farm Credit Administration, are considered "registered loan originators." All other mortgage loan originators are licensed by the states and considered "State-licensed loan originators."

Both the state licensing and federal registration processes are done through the same online registration system, the Nationwide Mortgage Licensing System and Registry (NMLSR), and include an FBI criminal background check, which requires fingerprints to be submitted. Financial institutions must then review the FBI background check in light of applicable law, including Section 19 of the FDIA and Section 205(d) of the FCUA (as discussed above).[27] The SAFE Act also requires all State-licensed loan originator applicants to provide the NMLSR with their personal history and experience, including authorization for the NMLSR to obtain an independent credit report from a consumer reporting agency and other information related to any administrative, civil or criminal findings by any governmental jurisdiction.[28]

"Covered financial institutions must have written policies for SAFE Act compliance. These policies must establish a process for reviewing employee criminal background reports received pursuant to the regulations and for taking appropriate actions that are consistent with applicable federal law and regulations. Institutions must also have a process in place for maintaining records of the reports and actions taken with respect to applicable employees."[29]

[26] The SAFE Act defines a mortgage loan originator as an individual who (1) takes a residential mortgage loan application and (2) offers or negotiates terms of a residential mortgage loan for compensation or gain. The term mortgage loan originator does not include an individual who performs purely administrative or clerical tasks on behalf of an individual who is a mortgage loan originator." *Berkowitz, infra* note 47.

[27] Littler Mendelson, *supra* note 12, at 17.

[28] "Secure and Fair Enforcement for Mortgage Licensing Act of 2008" (Pub. L. 110-289), § 1505(a).

[29] Littler Mendelson, *supra* note 12, at 17.

Similarly, Regulation Z of the Truth in Lending Act (Reg. Z)[30] was issued under the Dodd-Frank Act and generally applies to "loan originators" involved in consumer credit transactions secured by a dwelling, such as mortgage loan transactions.[31] However, Reg. Z's definition of "loan originator" is broader than the definition of "mortgage loan originator" under the SAFE Act. Further, Reg. Z imposes additional qualification requirements on a loan originator who is not required to be licensed under the SAFE Act.[32]

Under Reg. Z, "loan originator" is expanded to mean a person who, in expectation of direct or indirect compensation or other monetary gain or for direct or indirect compensation or other monetary gain, performs any of the following activities: takes an application, offers, arranges, assists a consumer in obtaining or applying to obtain, negotiates or otherwise obtains or makes an extension of consumer credit for another person; or through advertising or other means of communication, represents to the public that he or she can or will perform any of these activities. The term "loan originator" includes an employee, agent or contractor of the creditor or loan originator organization if the employee, agent or contractor meets this definition.[33]

Some of the Reg. Z requirements overlap with SAFE Act requirements, but Reg. Z includes some additional qualification requirements. Reg. Z's additional requirements include: 1) collecting background information about the individual; and 2) determining whether the individual is qualified.[34]

1. **Collect background information**
   Organizations that employ covered "loan originators" under Reg. Z must collect background information about that individual, including: 1) "a criminal background check through the Nationwide Mortgage Licensing System and Registry (NMLSR) or, in the case of an individual loan originator who is not a registered loan originator under the NMLSR, a criminal background check from a law enforcement agency or commercial service; 2) a credit report from a consumer reporting agency described in section 603(p) of the Fair Credit Reporting Act (15 U.S.C. 1681a(p)) secured, where applicable, in compliance with the requirements of section 604(b) of the Fair Credit Reporting Act, 15 U.S.C. 1681b(b); and 3) information from the NMLSR about any administrative, civil, or criminal findings by any government jurisdiction or, in the case of an individual loan originator who is not a registered loan originator under the NMLSR, such information from the individual loan originator."[35]

   "A credit report may be obtained directly from a consumer reporting agency or through a commercial service. A loan originator organization with access to the NMLSR can meet the requirement for the criminal background check by reviewing any criminal background check it receives upon compliance with the requirement in 12 CFR 1007.103(d)(1) and can meet the requirement to obtain information related to any administrative, civil, or criminal determinations by any government jurisdiction by obtaining the information through the NMLSR. Loan originator organizations that do not have access to these items through the NMLSR

[30] 12 CFR Part 1026 ("Reg. Z").

[31] Littler Mendelson, *supra* note 12, at 20.

[32] *Id.*

[33] 12 CFR Part 1026, § 1026.36(a), https://www.consumerfinance.gov/eregulations/1026-36/2016-14782_20160627#1026-36-a.

[34] Littler Mendelson, *supra* note 12, at 19.

[35] 12 CFR Part 1026, § 1026.36(f)(3), https://www.consumerfinance.gov/eregulations/1026-36/2016-14782_20160627#1026-36-f-3.

may obtain them by other means. For example, a criminal background check may be obtained from a law enforcement agency or commercial service. Information on any past administrative, civil, or criminal findings (such as from disciplinary or enforcement actions) may be obtained from the individual loan originator."[36]

2. **Determine whether the individual is qualified**

In determining whether an individual is qualified, organizations must conclude that the person: 1) has not been convicted of, or pleaded guilty or nolo contendere to, a felony in a domestic or military court during the preceding seven-year period or, in the case of a felony involving an act of fraud, dishonesty, a breach of trust, or money laundering, at any time; and 2) has demonstrated financial responsibility, character, and general fitness that indicates that the individual will operate honestly, fairly, and efficiently.[37]

In order to demonstrate compliance with the above requirements, organizations should establish and follow written procedures.[38] For purposes of assessing criminal history in accordance with the above requirements, "a crime is a felony only if at the time of conviction it was classified as a felony under the law of the jurisdiction under which the individual was convicted."[39] Further, "expunged convictions and pardoned convictions do not render an individual unqualified."[40] Finally, a conviction or plea of guilty or nolo contendere does not render an individual unqualified under § 1026.36(f) if the loan originator organization has obtained consent to employ the individual from the FDIC (or the Board of Governors of the Federal Reserve System, as applicable) pursuant to Section 19 of the FDIA, or from the NCUA pursuant to Section 205 of the FCUA.[41]

To determine financial responsibility, character and general fitness, an organization must assess all reasonably available information discoverable during a prudent hiring process.[42] This can include information such as the existence of current outstanding judgments; tax liens; other government

[36] *See* Official Interpretation to 12 CFR Part 1026, § 1026.36(f)(3), https://www.consumerfinance.gov/eregulations/1026-36/2016-14782_20160627#1026-36-f-3-i-A.

[37] 12 CFR Part 1026, § 1026.36(f)(3)(ii)(A), https://www.consumerfinance.gov/eregulations/1026-36/2016-14782_20160627#1026-36-f-3-ii-A.

[38] Littler Mendelson, *supra* note 12, at 22.

[39] 12 CFR Part 1026, § 1026.36(f)(3)(ii)(A), https://www.consumerfinance.gov/eregulations/1026-36/2016-14782_20160627#1026-36-f-3-ii-A.

[40] *Id.*

[41] *Id.*

[42] Littler Mendelson, *supra* note 12, at 22. *See also* Official Interpretation to 12 CFR Part 1026, § 1026.36(f)(3)(ii)(B), https://www.consumerfinance.gov/eregulations/1026-36/2016-14782_20160627#1026-36-f-3-ii-B.

liens; nonpayment of child support; or a pattern of bankruptcies, foreclosures or delinquent accounts. Organizations are not required to consider debts arising from medical expenses and may be able to limit the time frame for considering bankruptcies and foreclosures.[43]

A review and assessment of character and general fitness is sufficient if it considers, as relevant factors, acts of unfairness or dishonesty, including dishonesty by the individual in the course of seeking employment, dishonesty concerning qualifications and any disciplinary actions by regulatory or professional licensing agencies.[44]

"No single factor necessarily requires a determination that the individual does not meet the standards for financial responsibility, character, or general fitness, provided that the loan originator organization considers all relevant factors and reasonably determines that, on balance, the individual meets the standards."[45] However, "the absence of any significant adverse information is sufficient to support an affirmative determination that the individual meets the standards."[46]

D. Broker-Dealers

Rule 17a-3(a)(12) of the Securities Exchange Act of 1934 and FINRA Rule 3110(e) set forth background investigation and verification requirements for broker-dealers and FINRA members.

Rule 17a-3(a)(12) of the Securities Exchange Act of 1934 requires "members and broker-dealers to make and keep current certain books and records with respect to 'associated persons' of the firm, including an executed 'questionnaire or application for employment' containing information regarding the 'associated person,' including, without limitation, a record of any arrests and indictments for any felony or certain enumerated misdemeanors (e.g., securities, banking, insurance or real estate related crimes, fraud, false statements or omissions, wrongful taking of property, bribery, forgery, counterfeiting, extortion), and the disposition of such arrests and indictments."[47]

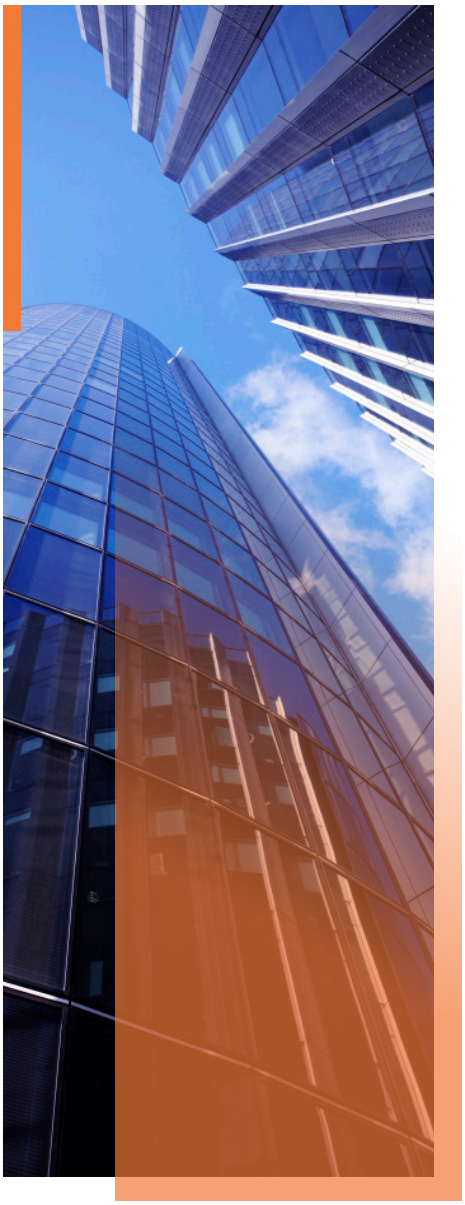
[43] *Id.*

[44] *Id.*

[45] *See* Official Interpretation to 12 CFR Part 1026, § 1026.36(f)(3)(ii)(B), https://www.consumerfinance.gov/eregulations/1026-36/2016-14782_20160627#1026-36-f-3-ii-B.

[46] *Id.*

[47] Philip M. Berkowitz, *Background Checks in Banks, Conflicts with New Laws*, Littler Mendelson P.C. (Mar. 10, 2016), https://www.littler.com/publication-press/press/background-checks-banks-conflicts-new-laws.



Additionally, Financial Industry Regulatory Authority ("FINRA") Rule 3110(e): Responsibility of Member to Investigate Applicants for Registration ("Rule 3110(e)")[48] requires member firms to adopt written background check procedures that include a national search of "reasonably available" public records. Rule 3110(e) requires that members investigate the good character, business reputation, qualifications and experience of an applicant before registering the applicant with FINRA and further requires firms to have procedures in place to verify the accuracy and completeness of information contained in the Form U4, which should include a search of reasonably available public records. Rule 3110(e) also addresses the timing of FINRA's various background check and investigation requirements, and encourages members to conduct all verifications and searches prior to filing the Form U4, whenever possible, as a best practice.

1. **Investigation Requirement**
   First, Rule 3110(e) clarifies that members must ascertain by investigation the good character, business reputation, qualifications and experiences of an applicant before the member applies to register the applicant with FINRA and before making a representation to that effect on the application for registration. This is essentially a restatement of a previously existing National Association of Securities Dealers (NASD) rule, but with an explicit clarification that firms must conduct this investigation before applying to register the applicant with FINRA.

2. **Verification Requirement**
   Second, Rule 3110(e) requires that members "establish and implement written procedures reasonably designed to verify the accuracy and completeness of the information contained in an applicant's initial or transfer Form U4." This requirement is elaborated further, stating that a member's written procedures must, at a minimum, provide for a search of "reasonably available public records." The public records search can be conducted either by the member firm or through a third-party service provider.

   FINRA has stated that the definition of "reasonably available public records" may change over time, but some records it currently believes to be reasonably available include criminal records, bankruptcy

[48] FINRA Rule 3110(e), *available at* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=11345.

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records, judgments and liens. This is, however, a minimum or base requirement—"firms may find it necessary to conduct a more in-depth search of public records depending on the applicant's job function, responsibilities, or position at the firm."[49] These additional public records could include civil litigation and business records.

Further, "FINRA does not expect firms to verify all of the information in the Form U4 where such verification is not feasible or practical. However, in such cases, a firm should document that the information could not be verified and the reasons (including the steps taken to verify the information)."[50]

3. **Timing**

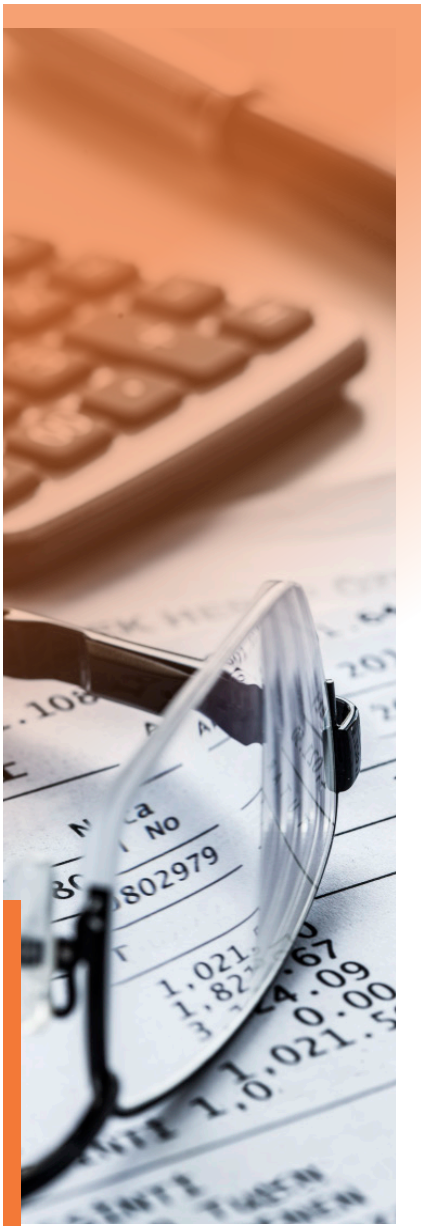
The first requirement—that members ascertain by investigation the good character, business reputation, qualifications and experience of an applicant—must be done before the member applies to register the applicant with FINRA. The second requirement—a search of reasonably available public records—must be done no later than 30 calendar days after the Form U4 is filed with FINRA, with the understanding that if the firm becomes aware of any discrepancies as a result of the verification process conducted after the filing of the Form U4, it will be required to file an amended Form U4. However, FINRA has emphasized that the verification process is not limited to only the 30 days following the filing of a Form U4, and can be done prior to this time period. "The 30-day window is intended to accommodate firms that may find it difficult to conduct the verification process before filing an applicant's Form U4, such as where an applicant is hired immediately to fill a needed role at the firm."[51]

In response to comments asking whether the investigation and verification requirements are duplicative, FINRA stated that the requirements are complimentary but are not the same. FINRA noted that the investigation requirement is a principle-based requirement that requires members to use the resources that are necessary and lawful in order to investigate the background of an applicant.[52] The verification requirement specifically asks that the member verify the information contained on the Form U4. Although the two requirements are separate, some of the information obtained while satisfying these two requirements may overlap. Thus, for most applicants, FINRA expects that firms will conduct the investigation and verification process concurrently using some of the same information and prior to filing the Form U4.[53] This is also a best practice for member firms because it will allow them to avoid any late disclosure fees that may be incurred if the search is conducted after filing the Form U4.

4. **Implementation**

In order to implement Rule 3110(e), firms will first need to identify the information on the Form U4 that can be verified, then establish a written policy that spells out how the firm will verify this information. This process will likely vary firm by firm, but will generally require that members conduct a comprehensive background check, that includes a criminal record check, a credit check,

[49] See Regulatory Notice 15-05, FINRA 4 (2015), *available at* http://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_15-05.pdf.
[50] *Id.* at 3.
[51] *Id.*
[52] *Id.* at 2.
[53] *Id.* at 3-4.



employment history verification, professional designations verification and a regulatory/disciplinary actions search.

E. Investment Advisers

Unlike FINRA member firms and broker-dealers, investment advisers are not governed by a self-regulatory organization (SRO). There also is no federal law mandating background checks for employees of SEC-registered investment advisers.[54]

Under the Investment Advisers Act of 1940, registered investment advisers are required to disclose certain financial and disciplinary information in Form ADV. "The SEC may deny registration if an adviser or any 'person associated with the adviser': 1) makes false or misleading statements in its registration application; 2) has within the past 10 years been convicted of a felony; 3) has been convicted by a court or found by the SEC to have violated a securities-related statute or rule; or 4) has been the subject of a securities-related injunction, or similar legal action."[55]

However, unlike the Form U4, the Form ADV does not contain specific requirements that mandate criminal background checks for employment purposes—it only asks questions for disclosure purposes.[56] Thus, Form ADV's disclosure-oriented obligations do not prohibit an applicant from being employed by an investment adviser."[57]

2. "Ban the Box" and Financial Services

In the past few years, the passage of "Ban the Box" legislation, or legislation that limits an employer's ability to inquire into a job applicant's criminal history, has been on the rise across the nation, both on the state and local level. "Ban the Box" refers to the box appearing on many employment applications, asking an applicant to check whether he or she has a criminal record. The idea behind the movement is that by deferring the disclosure of past transgressions until an employer is already knowledgeable about an applicant's qualifications and experiences, an employer is more likely to objectively assess the relevance of such information.

[54] Littler Mendelson, *supra* note 12, at 27.
[55] *Id.*
[56] *Id.* at 28.
[57] *Id.*

The prohibitions and requirements of each law or policy vary substantially from jurisdiction to jurisdiction and thus require that employers closely analyze the language of the law in each jurisdiction to ensure compliance. But while the laws vary in their application and implementation, they all commonly establish parameters for when, and to what extent, an employer may ask about or use criminal history for employment purposes and generally never prohibit criminal history inquiries (or criminal background checks) altogether. Instead, these laws require such inquiries to be postponed until later in the application process (e.g. after an interview; once an applicant is a finalist for the position or has received a conditional offer).

While many of these "Ban the Box" laws include exceptions if the practices they prohibit are permitted or required by another law, the applicability of such exceptions to financial institutions may be challenging due to the wording of each jurisdiction's exception as well as the ambiguous nature of background check requirements across the financial services industry. A financial institution's analysis of the applicability of various "Ban the Box" laws is further complicated by the varying definitions of "employment," with some definitions covering individuals hired as independent contractors or agents, while others may not.

A. Complications with "Ban the Box" Exceptions

"Ban the box" laws can include several exceptions that make the law inapplicable in certain situations. While application of these exceptions tends to be fairly straight forward, others may not be as easy to apply. One exception that some jurisdictions provide makes the "Ban the Box" law inapplicable only if another state or federal law requires the organization to engage in practices prohibited by the "Ban the Box" law, such as conducting a criminal records check or asking about criminal history on an employment application. Employers relying on this exception would have to first determine what exactly is required of them by another state or federal law and then look to the language of the "Ban the Box" law to determine whether those other legal requirements are in fact inconsistent with the "Ban the Box" requirements.

The first issue arises when determining what exactly is required by the other state or federal law. For example, does the law outright prohibit an organization from employing an individual with a

certain conviction, or does it merely require that the organization more closely assess that individual's candidacy? Does the law specifically require an organization to ask applicants about criminal history, and if so, does it specify when this must be done? As previously mentioned, "Ban the Box" policies generally do not prohibit criminal history inquiries altogether—instead they typically require employers to delay such inquiries until later in the application process. If the "Ban the Box" law provides an exemption only when an employer is legally required to ask about criminal history on an employment application, this may not provide a blanket exception for some institutions. Whether the institution or positon is exempt would depend on whether the laws and regulations governing that institution require it to ask about criminal history on an initial application, or whether they allow for such inquiries to be delayed until later in the application process. To the extent that any law requiring financial institutions to ask about criminal histories or conduct criminal background checks allows for such practices to be delayed until made lawful by that jurisdiction's "Ban the Box" law, institutions may be required to comply with those "Ban the Box" requirements depending on the wording of the "Ban the Box" exception.

For example, federally insured depository institution are required to perform a "reasonable inquiry" regarding an applicant's history to avoid hiring or permitting participation by a person with a covered conviction, and FDIC guidance indicates that this would include asking about convictions on a written employment application. Alternatively, while insurance companies are required to attempt to identify whether any present employees or prospective employees have been convicted of any felonies involving dishonesty or breach of trust, the VCCA does not explicitly state that insurance companies must ask about criminal histories on initial employment applications. Thus, if a jurisdiction only exempts those institutions that are required to ask about criminal histories on employment applications, an insured depository institution operating in that jurisdiction would arguably be exempt, but an insurance company in the same jurisdiction would have to undertake a more detailed legal analysis.

This exemption is also tricky for financial institutions because background check laws may not explicitly require institutions to ask about criminal records or conduct criminal background checks, but such practices may be understood as what is generally required to comply with broader statutory or regulatory requirements. For example, the aforementioned FDIC guidance to banks and federally insured institutions states that asking about criminal histories on employment applications helps satisfy the "reasonable inquiry" requirement, but neither FDIC nor NCUA guidance states that a criminal background check is mandatory. Thus, such institutions would have

to make a determination on whether this vague legal requirement is sufficient to exempt them from complying with a jurisdiction's "Ban the Box" law that either prohibits criminal background checks altogether or requires such checks to be delayed until later in the application process.

To illustrate the complexities with this "if required by another state or federal law" exception, we can look to the City of Philadelphia's "Ban the Box" law, which prohibits employers from making "any inquiry regarding or to require any person to disclose or reveal any criminal convictions during the application process. … The application process shall begin when the applicant inquiries about the employment being sought and shall end when an employer has extended a conditional offer of employment to the applicant." The law further provides that "no employer shall maintain a policy of automatically excluding any applicant with a criminal conviction from a job or class of jobs." Finally, the law states that its prohibitions "shall not apply if the inquiries or adverse actions prohibited herein are specifically authorized or mandated by any other applicable law or regulation."

A financial institution operating in Philadelphia would have to determine whether background check laws governing it "specifically authorize or mandate" that it inquire into criminal histories before making a conditional offer of employment or that it exclude candidates based on certain criminal convictions before engaging in such practices in this jurisdiction.

B. Applicability to Independent Contractors and Agents

Another issue arises in the financial services/insurance industry when determining whether "employment" includes those individuals working as agents or independent contractors. Some jurisdictions explicitly define "employment" to include individuals who are independent contractors or agents, while others provide no guidance on the issue.

For example, New York City's "Ban the Box" law states that "natural persons employed as independent contractors to carry out work in furtherance of an employer's business enterprise who are not themselves employers shall be counted as persons in the employ of such employer."

Similarly, Philadelphia's "Ban the Box" law defines "employment" to include "any occupation, vocation, job, work for pay or employment, including ... contracted work, contingent work ... "

Los Angeles defines "employment" to include contracted work, contingent work, work on commission and work through the services of a temporary or other employment agency. The "Ban the Box" laws in all of these jurisdictions arguably cover independent contractors.

Alternatively, the "Ban the Box" law in Portland, Oregon states that: "'Employ' means to engage or use the personal service of another person on a full-time, part-time, temporary or seasonal basis, where the Employer reserves the right to control the means by which such service is performed." While this definition does not explicitly exclude independent contractors, it could arguably be interpreted as excluding such individuals considering independent contractors must typically be given independent discretion to determine how services are performed. Thus, organizations operating in these jurisdictions would have to make a determination on whether the law applies to such positions and adjust their practices accordingly.

3. Credit History Restrictions

Similar to the "Ban the Box" laws limiting criminal history inquiries, a growing number of jurisdictions are now passing laws that prohibit employers from considering credit history information in making employment decisions. Unlike the "Ban the Box" laws, which allow criminal history inquiries to be made later in the application process, credit history laws tend to prohibit credit history inquiries altogether. Such laws also include exceptions for certain institutions, or for certain positions within institutions, as well as for when credit inquiries are required by other laws, but these exceptions can give rise to the same issues highlighted above.

One additional issue for financial institutions arises when determining which applicants or employees are exempt from a particular credit restriction law. The wording of these exemptions varies by jurisdiction and may exclude an institution as a whole or more narrowly exempt only certain positions within the institution. Thus, such laws require that organizations closely analyze the language of the exemptions provided in each jurisdiction to determine whether the organization as a whole qualifies for an exemption or whether

the exemption is limited to only certain positions within the organization. If only certain positions within the organization are exempt, it is important that the organization determine which positions fall into the exempt category, and then have clearly defined policies and procedures in place so as to ensure continued compliance for nonexempt positions.

To illustrate this potential issue for employers, we can look to New York City's recent "Stop Credit Discrimination in Employment Act" (SCDEA), which "generally prohibits employers from requesting or using a potential or existing employee's credit history—including credit reports, credit scores, and other information regarding a person's credit, bankruptcies, judgments or liens—when making hiring, promotion, firing and other employment determinations."[58] The SCDEA provides an exemption for employers who are required by state or federal law or regulation, or by the rules of a self-regulatory organization (SRO), to use an individual's consumer credit history for employment purposes.[59]

According to the Interpretive Enforcement Guide issued by the New York City Commission on Human Rights,[60] the SCDEA exemption for employers complying with rules and regulations promulgated by an SRO, such as FINRA, "only exempts employers required by FINRA to use consumer credit history when confirming the completeness and accuracy of an applicant or employee's disclosures to FINRA or when making employment decisions about individuals required to register with FINRA." Thus, "the commission takes the position that this exemption does not extend to employment decisions regarding individuals not required to register with FINRA, including, but not limited to, those who perform functions that are supportive of (or ancillary or advisory to) those for whom registration is required, or who engage solely in clerical or ministerial activities."[61]

While some positions within a FINRA firm may be exempt, the SCDEA may continue to apply to a FINRA member's employment decisions regarding individuals not required to register with FINRA or who are not otherwise regulated by FINRA.[62] Employers must be aware of the nuances of these exceptions and must have procedures in place to ensure compliance with credit history restrictions when appropriate.

[58] Berkowitz, *supra* note 47.
[59] *Id.*
[60] https://www1.nyc.gov/site/cchr/law/stop-credit-discrimination-employment-act.page
[61] Berkowitz, *supra* note 47.
[62] *Id.*

Conclusion

Financial institutions, including insurance companies, banks, credit unions and broker-dealers, now face the growing challenge of navigating a complex labyrinth of federal and state background screening and investigation requirements. State and local antidiscrimination laws contribute to this complexity by prohibiting practices that firms regularly engage in, such as considering criminal records and credit history information in employment decisions, either in compliance with legal requirements or to otherwise protect the interests of their various stakeholders.

While many "Ban the Box" laws include exceptions if the practices they prohibit are permitted or required by other laws, applying such exceptions is challenging for many institutions due to the wording of each jurisdiction's exception as well as the ambiguous nature of many background check laws in the financial services industry. Institutions must determine what exactly the various state or federal background investigation laws require of them, and then look to the language of the "Ban the Box" laws in each jurisdiction to determine whether their legal requirements are in fact inconsistent with the "Ban the Box" requirements.

A financial institution's analysis of the applicability of various "Ban the Box" laws is further complicated by the varying definitions of "employment"—institutions must analyze the definition of this term in each jurisdiction to determine whether the law applies to individuals hired as independent contractors or agents.

Financial institutions may also run into similar challenges when determining the applicability of credit history restriction laws and the accompanying exceptions, and should ensure that any such exceptions are being applied appropriately, including when the language of any such exception only excludes certain positions within the institution (rather than the institution as a whole).

Finally, as background screening laws and regulations on both the state and federal level continue to change and evolve on a daily basis, institutions would be well-advised to dedicate resources to monitoring such changes and to ensure that revisions to these practices and policies are made accordingly.