

Hedge Up

A Heads-Up on Employment Issues Confronting the Hedge Fund Industry

September 17, 2015

If you read one thing...

- Two new employment statutes place additional burden on New York City firms during prospective employee screening and provide fodder for the plaintiffs' bar
- Credit history and criminal background checks affected by the new laws
- NYC firms should review onboarding procedures and employee policies to ensure compliance with the new laws



Two New NYC Statutes Constrain Hiring Process

Two new employment statutes place additional restrictions on New York City firms looking to vet potential new hires. The Stop Credit Discrimination in Employment Act (SCDEA) went into effect earlier this month, while the Fair Chance Act (FCA) goes into effect on October 27, 2015. Both laws are amendments to the New York City Human Rights Law (NYCHRL), one of the most notoriously employee-friendly, antidiscrimination statutes in the country.

The Stop Credit Discrimination in Employment Act

The SCDEA prohibits firms from requesting or using an individual's consumer credit history in making hiring and other employment-related decisions, including with respect to compensation or other terms, conditions or privileges of employment. "Consumer credit history" is defined to include an individual's credit-worthiness, credit standing, credit capacity or payment history, as indicated by (a) a consumer credit report; (b) a credit score; or (c) other information obtained directly from the individual regarding (i) his or her credit accounts, including number of credit accounts, late or missed payments, charged-off debts, items in collections, credit limit or prior credit report inquiries; or (ii) bankruptcies, judgments or liens. Requesting a consumer credit history from either the applicable individual or a consumer reporting agency can be a violation of the SCDEA, even if no adverse employment action is subsequently taken against the individual.

The SCDEA applies not only to applicants interviewing for positions, but also to a firm's existing employees. Individuals asserting claims under the SCDEA can pursue the same remedies as other individuals asserting claims under the NYCHRL, including backpay, equitable relief, compensatory and punitive damages, and attorneys' fees and costs. The New York City Commission on Human Rights ("Commission") also can pursue claims under the SCDEA and can impose civil penalties of up to \$250,000 per violation for willful violations.

The SCDEA contains several exceptions that may be applicable to certain positions or roles at investment managers. The Commission has warned, however, that these exceptions should be construed narrowly and has suggested that firms will “have the burden of proving by the preponderance of the evidence” that a particular exception applies in any case. Among the exceptions are the following:

- First, credit checks are permitted when required by federal or state law or regulation, or by a self-regulatory organization as defined in Section 3(a)(26) of the Securities Exchange Act of 1934. This exception would apply to Financial Industry Regulatory Authority (FINRA)- or National Futures Association (NFA)-registered employees of investment managers affiliated with broker-dealers.
- Second, the use of credit history information is permitted for individuals who will serve in non-clerical positions and who will have “regular access to trade secrets.” “Trade secrets” are defined narrowly to include only information that (a) derives actual or potential economic value from not being known to others, (b) is subject to reasonable efforts to maintain its secrecy and (c) “can reasonably be said to be the end product of significant innovation.” This exception arguably would apply to individuals with direct access to a firm’s investment and trading strategies, proprietary software, algorithms or other aspects of a firm’s operations that give it a competitive edge in the marketplace. According to the Commission’s recent guidance, however, this exception does not apply to “formulas, customer lists, processes, and other information regularly collected in the course of business or regularly used by entry-level and non-salaried employees and supervisors or managers of such employees.”
- Third, the statute allows the use of consumer credit information for individuals who will serve in positions (a) “having signatory authority over third-party funds or assets valued at \$10,000 or more,” or (b) involving “a fiduciary responsibility ... with the authority to enter financial agreements valued at \$10,000 or more.” The Commission’s recent guidance suggests that this exception is intended to include “executive-level positions with financial control over a company,” such as a chief financial officer or chief operating officer, and that it should not be construed broadly to include, for example, “all staff in a finance department.”
- Fourth, a firm can run credit checks on individuals who will serve in positions that will regularly allow them to “modify digital security systems established to prevent the unauthorized use” of the firm’s or its clients’ networks or databases. As with the financial fiduciary exception discussed above, the Commission has stated that this exception is intended to cover executive-level positions.

According to the Commission, firms availing themselves of an exemption should (a) inform applicants or employees of the claimed exemption, and (b) keep a log containing detailed information supporting the exemption for a period of five years.

Notably, the Commission’s guidance states that “[t]he SCDEA does not prevent employers from researching potential employees’ background and experience, evaluating their resumes and references, and conducting online searches (e.g., Google and LinkedIn)” (emphasis added). Investment managers thus may be able to obtain some credit-related information about applicants and employees without triggering the new law.

It will take some time for the exact contours of the SCDEA and the applicable exceptions to get fleshed out in the courts. There are certain to be battles over the meaning of the statutory text and the degree to which the Commission's interpretations are entitled to judicial deference. In the meantime, New York City-based investment managers should be discerning in conducting credit checks on their employees or applicants. To the extent possible, firms should consider running such checks on a case-by-case basis, based on the expected responsibilities of the position. We expect the Commission and the plaintiffs' bar to aggressively pursue claims under the new law, particularly where an individual is rejected for employment or fired as a result of information obtained from a credit check or where a larger employer continues broadly running background checks on employees, inspiring putative class claims or other claims of systemic breaches.

Fair Chance Act

On October 27, 2015, the FCA will go into effect. The FCA is a "ban the box" law that prevents New York City firms from conducting criminal background checks or inquiring about an applicant's arrest or conviction history until after extending a conditional offer of employment to the applicant. The law prohibits pre-offer inquiries on an employment application, in an interview, through the searching of public records or databases, or through consumer reports containing criminal background information. The law also prohibits firms from using advertisements or other solicitations that suggest any requirements with respect to the arrest or conviction history of potential candidates.

After extending a conditional offer of employment to an applicant, a firm can obtain and utilize criminal background information, but must comply with detailed notice procedures before taking adverse action based upon the information it obtains. These steps include (a) providing written notice to the applicant of the information the firm is seeking (in a form to be determined by the Commission); (b) performing an eight-pronged analysis of the degree to which any arrest or conviction history is relevant given the position at issue, in accordance with Article 23-A of the New York Corrections Law; (c) providing the applicant with a written copy of such analysis, including the reasons for the decision to withdraw the conditional offer, and providing any supporting documentation; and (d) holding the position open for at least three business days after providing this information so that the applicant can respond with additional or mitigating information.

Like the SCDEA, the FCA does not apply to positions where criminal background checks are required by governing law or an applicable self-regulatory organization. Individuals pursuing claims under the FCA can seek the remedies available under the NYCHRL, including back pay, equitable relief, compensatory and punitive damages, and attorneys' fees and costs.

The SCDEA and FCA require firms operating in New York City to think carefully about their background check policies with respect to employees and applicants. Firms should review their onboarding procedures, as well as their written policies, to try to ensure compliance with the new laws. Obviously, firms also should ensure that their processes comply with other applicable laws, such as the federal Fair

Credit Reporting Act (FCRA), the New York State Human Rights Law, and the provisions of the NYCHRL prohibiting discrimination based on an individual's arrest or conviction history.

Contact Information

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