

December 2011

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Recommended Citation

Kelly Noonan, *An Industry Missing Minorities: The Disparate Impact of the Securities and Exchange Commission's Fingerprinting Rule*, 87 Chi.-Kent L. Rev. 299 (2012).

Available at: <https://scholarship.kentlaw.iit.edu/cklawreview/vol87/iss1/12>

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AN INDUSTRY MISSING MINORITIES: THE DISPARATE IMPACT OF THE SECURITIES AND EXCHANGE COMMISSION'S FINGERPRINTING RULE

KELLY NOONAN*

INTRODUCTION

Employers in the United States must be careful to comply with the numerous laws and regulations enacted by the government to protect employees.¹ Employers whose businesses are subject to regulation by industry-specific federal agencies created to protect the public interest² face the further burden of compliance with the applicable rules and regulations of their respective industries. Given the vast range of federal rules and regulations impacting U.S. employers, conflicts will inevitably arise, which can create a dilemma for employers.

Employers in the securities industry face just such a dilemma as they strive to comply with both Title VII of the Civil Rights Act of 1964 and the Securities and Exchange Commission's (SEC) requirement to disqualify from employment any job applicants or employees who have been convicted of various misdemeanors or felonies.³ Section 15b(4)(1) of the Securities Exchange Act of 1934 requires that the SEC limit the activities, including suspending privileges or revoking registrations, of any employee or broker-dealer⁴ that employs an individual who has been convicted of certain types of misdemeanors or felonies.⁵ Thus, the SEC enacted a rule that requires the vast majority of employees in the securities industry to

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1. Examples include Title VII, the Americans with Disabilities Act, and worker's compensation laws.

2. Examples include the Securities and Exchange Commission, the Food and Drug Administration, and the Federal Aviation Administration.

3. 15 U.S.C. § 78o(b)(4) (2006).

4. A broker-dealer is a person or firm engaged in the business of buying and selling securities for the accounts of others or for their own account. §78c(a)(4-5).

5. § 78o(b)(4). Such crimes include the "purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, . . . conspiracy to commit any such offense; larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds, or securities."

submit fingerprints for a criminal history check⁶ to determine whether such employees are statutorily disqualified⁷ from employment. This regulation may be in conflict with Title VII, which prohibits employment practices that appear neutral but have a disparate impact on a particular race.⁸ The Equal Employment Opportunity Commission (EEOC), the agency charged with ensuring compliance with Title VII,⁹ has asserted that the use of criminal background checks as a method of pre-employment screening can have a disparate impact on African Americans and Hispanics, who are more likely to have criminal conviction records.¹⁰

The language of the SEC's fingerprint rule has not kept pace with the changing structure of the trading industry in recent years, resulting in broad application of the rule. Of course, ensuring the safety of financial instruments and the trustworthiness of those charged with handling cash and securities is extremely important. Yet in its current form, the fingerprint rule goes beyond merely protecting money: it excludes many individuals with even minor criminal histories from working in the securities industry.¹¹ In today's business environment, the rule arguably covers nearly all positions at a trading firm despite some limiting language about the job roles to which it applies.¹²

This broad application of the fingerprint rule may have a disparate impact on African Americans and Hispanics in violation of Title VII. Title VII prohibits employment practices that adversely impact a protected class of individuals if the employment practice is not consistent with business necessity.¹³ The extensive list of offenses for which an individual is subject

6. See 17 C.F.R. § 240.17f-2 (2010).

7. This Note will use the term "statutorily disqualified" to refer to individuals who have been convicted of certain felonies or misdemeanors. See parenthetical *supra* note 5. Statutorily disqualified will also refer to persons convicted of any other felony in the past ten years. § 78(c)(a)(39)(F). Although persons can be statutorily disqualified for other reasons, this Note will only be looking at disqualifications resulting from criminal records.

8. See 42 U.S.C. § 2000e-2(k)(1)(A)(i) (2006).

9. § 2000e-5(a) (2006).

10. EEOC, Facts about Race/Color Discrimination 4 (October 21, 2009), www.eeoc.gov/facts/fs-race.pdf; *Compliant* at 3-4, *EEOC v. Freeman*, 2009 WL 5082565, (D.Md. Sept. 30, 2009) No. 8:09CV02573; *Complaint* at 2, *EEOC v. Peoplemark*, 2008 WL 4733865, (S.D.Mich. Sept. 29, 2008) No. 1:08-CV-00907.

11. See 15 U.S.C. § 78(o)(b)(4); § 78(c)(a)(39)(F); § 240.17f-2.

12. See § 240.17f-2(a)(1)(i) (An employee "... shall be exempt if that person: (A) is not engaged in the sale of securities; [or] (B) does not regularly have access to the keeping, handling or processing of (1) securities, (2) monies, or (3) the original books and records" of the firm). Even information technology employees will arguably have access to the books and records of the firm and thus may fall within the requirements of the fingerprint rule. See *id.*

13. § 2000e-2(k)(1)(A) A disparate impact claim requires petitioner to show that the employment practice at issue causes a disparate impact on a protected group; and that the practice is not related to the job in question and a business necessity, or if the respondent demonstrates the employment practice

to disqualification under the Securities Exchange Act and the wide array of job functions covered by the SEC's fingerprint rule create a barrier against working in the securities industry for many prospective employees with a past criminal record. Notably, incarceration rates for African American and Hispanic men are nearly 6.5 and 2.5 times greater, respectively, than incarceration rates for white men.¹⁴ Given that African Americans and Hispanics are significantly more likely to have criminal records as compared to white people,¹⁵ this rule has a greater impact on those races. Thus, employers are placed in a difficult position because compliance with the fingerprint rule could leave the employer vulnerable to claims of disparate impact.

This Note explores the disparate impact the SEC's fingerprint rule may have on African Americans and Hispanics. In Part I, this Note will explain the requirements of Title VII with respect to disparate impact claims and will examine the recent actions by the EEOC asserting that criminal background checks as a method of pre-employment screening can adversely impact African Americans and Hispanics. Part II will examine the SEC's fingerprint rule and whether the technological advances in the industry have resulted in unnecessarily broad application of the rule, beyond what could be legitimately considered a business necessity. Part III proposes that the SEC's fingerprint rule may have a disparate impact on minorities, contributing to low numbers of African Americans and Hispanics in the securities industry. Finally, Part IV recommends that the SEC narrow the scope of the fingerprint rule to achieve the intent of Section 15b(4)(1) of the Securities Exchange Act without unnecessarily excluding minorities from the industry.

I. DISPARATE IMPACT LIABILITY UNDER TITLE VII

Discrimination in employment decisions can manifest itself in a variety of ways. The most familiar and obvious form is direct discrimination. However, the Supreme Court recognized that even facially neutral employment actions may still effectually discriminate against protected classes.¹⁶ In recognizing disparate impact as a violation of Title VII, the

is consistent with business necessity, the petitioner must demonstrate that a less discriminatory, alternative is available.

14. See Bureau of Justice Statistics, *Prisoners in 2008 Bulletin 2* (focusing on Table 2) (U.S. Department of Justice, Revised June 30, 2010)

15. *Id.*

16. *Griggs v. Duke Power Co.*, 401 U.S. 424, 436 (1971) (finding that a requirement that employees have a high school diploma or to pass a standard intelligence test, which disproportionately disad-

Supreme Court provided employees protection against more subtle forms of discrimination.¹⁷

A. *Disparate Impact Generally*

The Supreme Court first recognized an employer's liability for employment practices that have a disparate impact on a protected class of employees in *Griggs v. Duke Power Company*.¹⁸ Congress subsequently codified the disparate impact ruling of *Griggs* in the Civil Rights Act of 1991.¹⁹ Consequently, Title VII prohibits employment practices that have a disparate impact on a group of individuals because of the group's race, religion, sex, or national origin.²⁰ For example, the Supreme Court has held that a requirement for employees at a power plant to have a high school diploma or pass a standardized intelligence test had a disparate impact in violation of Title VII because it disproportionately impacted African American employees and did not reasonably predict job performance.²¹ Employers are prohibited from using these employment practices even if the practice appears neutral and the discrimination was unintentional.²²

To demonstrate a *prima facie* case of disparate impact, a plaintiff must first identify the particular employment practice at issue, such as a general aptitude or physical strength test, and then demonstrate the causal connection between the practice and the adverse impact on the protected class.²³ Courts often rely on statistical evidence to demonstrate a causal connection between a given employment practice and the adverse result.²⁴ The statistics must demonstrate a disparity that is so substantial as to raise an inference of causation between the disparity and the employment practice.²⁵ Courts generally utilize either the "four-fifths" rule of statistical measurement or a standard deviation test for evaluating whether an inference of

vantaged African-American employees and applicants, violated Title VII unless the tests can be shown to be job related).

17. *See id.* at 432.

18. *Id.*

19. *See* 42 U.S.C. § 2000e-2(k)(1)(A); *Ricci v. DeStefano*, 129 S.Ct. 2658, 2672 (2009) (finding that Congress codified the disparate impact ruling of *Griggs* in 42 U.S.C. § 2000e-2(k)(1)(A)(i)).

20. § 2000e-2(k).

21. *Griggs*, 401 U.S. at 431–433.

22. *Lewis v. City of Chicago*, 130 S.Ct. 2191, 2197 (2010); *Ricci*, 129 S.Ct. at 2672.

23. *Lewis*, 130 S.Ct. at 2197; *Ricci*, 129 S.Ct. at 2672.

24. *See Watson v. Fort Worth Bank and Trust*, 487 U.S. 977, 978–979 (1988); *Waisome v. Port Auth. of New York & New Jersey*, 948 F.2d 1370, 1375 (2d Cir. 1991); *U.S. v. Vulcan Soc. Inc.*, 637 F.Supp.2d 77, 86 (E.D.N.Y. 2009).

25. *Watson*, 487 U.S. at 994–95; *Foxworth v. Penn. State Police*, 228 Fed App'x. 151, 158 (3d Cir. 2007); *Vulcan Soc. Inc.*, 637 F.Supp.2d at 86.

causation has been established for disparate impact cases.²⁶ The four-fifths test asserts that if the selection rate of any protected class is less than four-fifths or 80 percent of the rate for the group with the highest selection rate, the low selection rate will generally be viewed as evidence of an adverse impact for purposes of a disparate impact claim.²⁷ For the standard deviation test, courts have used statistical tests that measure the probability that a result is random when compared to a predicted result.²⁸ While the courts are not bound to rely on either test, both have been found to sufficiently demonstrate a causal connection between an employment practice and an adverse impact on a protected class.²⁹

If a plaintiff successfully establishes a *prima facie* case of disparate impact, Title VII provides employers an affirmative defense if the employer can demonstrate the employment practice is job related and a business necessity.³⁰ A business necessity may arise, for example, from the physical or educational requirements to perform a certain job.³¹ To establish an employment practice as job related and a business necessity, courts have looked closely at whether the characteristic in question is vital to the specific job role at issue.³² Specifically, courts have distinguished between preferences of employers or customers and a true business need.³³ A requirement for sales clerks to speak English may be a business necessity because the requirement directly impacts the employee's interaction with

26. See *Mems v. City of St. Paul, Dept. of Fire & Safety Services*, 224 F.3d 735, 740 (8th Cir. 2000) (finding the four-fifths rule may be used to determine if an employment practice has an adverse impact); *Waisome*, 948 F.2d at 1376 (finding the court has relied on both the four-fifths test and standard deviation analysis for evaluating adverse impact); *Vulcan Soc. Inc.*, 637 F.Supp.2d at 86 (finding the four-fifths test and standard deviation analysis are widely used to evaluate statistical evidence in disparate impact cases).

27. 29 C.F.R. § 1607.4D; *Mems*, 224 F.3d at 740.

28. See, e.g., *Waisome*, 948 F.2d at 1376; *Vulcan Soc. Inc.*, 637 F.Supp.2d at 88.

29. *Malave v. Potter*, 320 F.3d 321, (2d Cir. 2003); *Guardian Assoc of New York City Police Department, Inc. v. Civ. Service Comm. Of N.Y.*, 630 F.2d 79, 88 (2d Cir. 1980); *Green v. Town of Hamden*, 73 F.Supp.2d 192, 198 (D. Conn. 1999); see also *Vulcan Soc. Inc.*, 637 F.Supp.2d at 93.

30. See 42 U.S.C. § 2000e-2(k)(1)(A)(i); *Ricci v. DeStefano*, 129 S. Ct. 2658, 2673 (2009); *EEOC v. Dial Corp.*, 469 F.3d 735, 742 (8th Cir. 2006).

31. See, e.g., *Lanning v. Se. Pa. Transp. Auth.*, 308 F.3d 286, 288 (3d Cir. 2002) (finding minimum aerobic capacity was necessary requirement for successful performance of position as training cadet); *Contreras v. City of Los Angeles*, 656 F.2d 1267, 1284 (9th Cir. 1981) (finding the City of Los Angeles demonstrated an auditor examination was sufficiently relevant to the auditor position and therefore met the requirements of the business necessity defense).

32. See *Griggs v. Duke Power Co.*, 401 U.S. 424, 431-32 (1971) (finding persons who did not have a high school diploma and did not pass the standardized test continued to do well in their job roles and therefore the requirement was not a business necessity); *Lanning*, 308 F.3d at 288 (finding minimum aerobic capacity was necessary requirement for successful performance of position as training cadet).

33. See, e.g., *EEOC v. Sephora USA, LLC*, 419 F.Supp.2d 408, 416 (S.D.N.Y. 2005); *Bradley v. Paizzaco of Neb. Inc.*, 7 F.3d 795, 799 (8th Cir. 1993).

customers³⁴ whereas a customer preference for clean-shaven pizza delivery men is not a business necessity.³⁵

Further, the courts have established that to qualify as a business necessity the employment practice should be predictive of job performance and must be tailored to correctly measure the specified criteria as it applies to the individual employee.³⁶ General or overly broad criteria are not acceptable.³⁷ Employers should be able to demonstrate that the business practice is necessary for the “safe and efficient performance” of the particular job at issue,³⁸ or that there is a manifest relationship between the practice and the position in question.³⁹ Still, a plaintiff can overcome the affirmative defense of business necessity by demonstrating that an alternative, non-discriminatory employment practice could achieve the same business-related result.⁴⁰ For example, a test that directly measures the strength of prison guards may serve as a non-discriminatory alternative to minimum height and weight requirements.⁴¹

B. The Use of Criminal Background Checks

There is no clear guidance from the courts as to whether criminal background checks violate Title VII. The Supreme Court has yet to weigh in on the issue of criminal background checks as a pre-employment screening tool and their potential impact on minorities. Although the Supreme Court has addressed the business necessity defense,⁴² background checks call for unique consideration because they do not specifically relate to the individual’s ability to perform the job in the way an educational requirement or physical strength test does. Instead, criminal background checks raise the question of whether someone who previously committed a crime

34. See *EEOC*, 419 F.Supp.2d at 417 (finding requirement for sales staff to speak English when customers are present is not merely customer preference but legitimately goes to helpfulness and approachability of employees).

35. See *Bradley*, 7 F.3d at 799 (finding a no-beard policy for pizza delivery drivers, while preferred by customers, was not necessary to the business and had a disparate impact on African-American men).

36. *El v. Se. Pa. Transp. Auth.*, 479 F.3d 232, 240 (3d Cir. 2007) (citing *Dothard v. Rawlinson*, 433 U.S. 321, 332 (1977)). However, disparate impact cases are fact based so a business necessity defense must be evaluated on the merits of a particular case. *Id.* at 245.

37. *Id.* at 242 (citing *Dothard*, 433 U.S. at 332; *Albemarle Paper Co. v. Moody*, 422 U.S. 405, 431 (1975); *Griggs*, 401 U.S. at 431–32).

38. EEOC, Fact Sheet on Employment Tests and Selection Procedures 3 (Modified June 23, 2008), http://www.eeoc.gov/policy/docs/factemployment_procedures.html.

39. *Watson v. Fort Worth Bank and Trust*, 487 U.S. 977, 979 (1988).

40. 42 U.S.C. § 2000e-2(k)(1)(A)(ii).

41. *Dothard*, 433 U.S. at 331–32.

42. See *Watson*, 487 U.S. at 979; *Griggs*, 401 U.S. at 431.

is likely to commit a similar crime in the future and whether an employer can choose not to assume that risk.

Many employers would be unquestionably justified in refusing to hire persons convicted of certain types of crimes, such as extremely serious offenses⁴³ or crimes with high recidivism rates.⁴⁴ Employers would likely not be expected to assume the risk of hiring persons with these types of convictions if the concern for the safety of others or the potential financial loss was significant. For example, the Third Circuit held that a second degree murder conviction was relevant to the successful performance of a job as a para-transit driver because the position required the driver to be alone with vulnerable passengers.⁴⁵ Further, an employer should be able to establish that trustworthiness is an essential characteristic for a bank teller; the bank employer likely could justifiably refuse to hire someone with multiple theft convictions.⁴⁶ However, the issue becomes murkier when an applicant's past criminal conviction poses no threat to the safety of others, where the crime is not relevant to the job at issue, or when the time elapsed since the conviction raises questions as to whether the conviction itself is a likely indicator of future behavior.⁴⁷

The EEOC recognizes the dilemma faced by employers in wanting to protect their businesses, employees, and customers by learning about the criminal histories of prospective employees, while also attempting to avoid any selection process that adversely impacts minority applicants. Accordingly, the EEOC does not prohibit the use of background checks in pre-employment screening and acknowledges that in certain situations the use of criminal background checks is even mandated.⁴⁸ However, the EEOC makes clear that employers who use criminal background checks as a pre-employment screening tool must still comply with Title VII.⁴⁹

43. Examples include murder, sexual assault, and kidnapping.

44. Statistics indicate that within three years of arrest, the highest rates of recidivism occur for persons convicted of motor vehicle theft and possession of stolen property. PATRICK A. LANAGAN & DAVID J. LEVIN, BUREAU OF JUSTICE STATISTICS, SPECIAL REPORT, RECIDIVISM OF PRISONERS RELEASED IN 1994, 1 (U.S. Department of Justice, June 2002, NCJ 193427).

45. *El v. Se. Pa. Transp. Auth.*, 479 F.3d 232, 242–246 (3d Cir. 2007).

46. See EEOC, Pre-Employment Inquiries and Arrest & Conviction (last visited Aug. 28, 2010), www1.eeoc.gov/laws/practices/inquiries_arrest_conviction.cfm. An employer can lawfully refuse to hire an applicant if employer determines person cannot be trusted to perform the duties of the job when considering the job role and the nature and seriousness of the offense.

47. See *id.*

48. EEOC, *supra* note 10, at 4 (“Using criminal records as an employment screen may be lawful, legitimate, and even mandated in certain circumstances.”).

49. *Id.* (“However, employers that use criminal records to screen for employment must comply with Title VII’s non-discrimination requirements.”).

To avoid violating Title VII, employers should narrowly tailor criminal background check policies to prevent overly broad application of the policy to unnecessary job functions or to persons convicted of irrelevant crimes.⁵⁰ The Eighth Circuit found that a policy of refusing to hire anyone with a conviction other than a minor traffic offense was too broad to establish a business necessity defense.⁵¹ When applying the business necessity defense to criminal background checks, the Third Circuit reasoned that the screening policy must be able to determine which applicants or employees pose an unacceptable level of risk.⁵² The Third Circuit emphasized that determinations as to the business necessity of such screening policies are fact specific and need to be determined on a case by case basis.⁵³

Generally, employers are not afforded the opportunity to gather information relating to the circumstances surrounding the past conviction when they utilize a blanket exclusion policy for applicants with prior criminal convictions.⁵⁴ The circumstances surrounding a criminal conviction may provide clarity to an employer as to whether an individual is likely to repeat past behaviors or whether the person simply made a mistake from which she has learned her lesson. For example, by speaking with the employee about the criminal conviction, the employer might learn that a conviction for theft was a misunderstanding or regrettable choice made many years prior. As a result, the employer would be in the position to determine whether the criminal conviction is relevant to the job at issue. A blanket policy of excluding job applicants with a prior criminal conviction does not provide the employer an opportunity to make a decision that is tailored to the job role and the individual job applicant.⁵⁵

Conversely, criminal history screenings do not violate Title VII when tailored to fit the requirements of specific job roles and limited to convictions relevant to the job in question.⁵⁶ The EEOC encourages employers to evaluate the applicant's criminal history in connection with the particular

50. EEOC, *supra* note 46.

51. *Green v. Missouri Pac. R.R. Co.*, 523 F.2d 1290, 1298–1299 (8th Cir. 1975) (finding the business necessity defense could not justifiably exclude anyone convicted of a crime other than a minor traffic violation from every position).

52. *El v. Se. Pa. Transp. Auth.*, 479 F.3d 232, 245 (3d Cir. 2007).

53. *Id.*

54. See EEOC, *supra* note 46 (recommending that employers allow job applicants to explain the results of a criminal background check).

55. See *El*, 479 F.3d at 240 (finding that the employment practice must be tailored to measure the specific criteria as it applies to the individual employee in order to establish a business necessity defense).

56. See *id.* at 238–249. The Third Circuit found summary judgment appropriate where the employer dismissed a para-transit driver upon learning of a previous conviction for second degree murder due to public safety concerns.

job in question, the type of offense for which the applicant was convicted, and the time elapsed since the conviction occurred.⁵⁷ Further, the EEOC recommends that employers periodically reevaluate any testing or selection policies, such as background checks, to ensure that the requirements remain necessary as the job roles change.⁵⁸ The employer should update its policy if it finds that its selection process is out of date and no longer applicable to the job role at issue.⁵⁹

The difficulty of properly tailoring a criminal background check policy to comply with Title VII has recently led the EEOC to increase its focus on the issue, particularly in light of the disparate impact such policies can have on African Americans and Hispanics.⁶⁰ In 2008 and 2009, the EEOC filed two class action lawsuits claiming an event-planning company and a staffing agency's broad use of criminal history records in employment screening had an adverse impact on African American and Hispanic job applicants and that the screening policies were not consistent with business necessity.⁶¹ In August 2010, Carol Miaskoff, the EEOC Assistant Legal Counsel, stated that the EEOC sees the issue as a growing problem because new technology has increased the ease with which employers can access criminal history information.⁶² Additionally, other recently filed private lawsuits, including cases involving a large management consulting company and a transportation company, claim the employers' broad use of criminal background checks have a disparate impact on minorities.⁶³ The increased scrutiny on this employment practice highlights the dilemma faced by broker-dealers who have a regulatory obligation to conduct crimi-

57. EEOC, *supra* note 46.

58. EEOC, *supra* note 38, at 5 (suggesting employers update testing procedures to ensure they remain relevant to success in the job position).

59. *Id.*

60. See Complaint, EEOC v. Freeman Co., *supra* note 10, at 3 (claiming company's use of criminal background checks as a method of pre-employment screening has a disparate impact on African-Americans and Hispanics); EEOC, Policy Statement on the Issue of Arrest and Conviction Records Under Title VII of the Civil Rights Act of 1964, as amended, 42 U.S.C. § 2000e *et seq.* (1982), (Last Modified September 11, 2006), <http://www.eeoc.gov/policy/docs/convict1.html>. The EEOC's position is that excluding prospective employees based on past criminal convictions adversely impacts African-Americans and Hispanics.

61. See Complaint, EEOC v. Freeman Co., *supra* note 10; *Compliant*, EEOC v. Peoplemark, *supra* note 10.

62. Molly McDonough, *EEOC: Overusing Background Checks May Lead to Discrimination*, ABA JOURNAL, LAW NEWS NOW (August 10, 2010), http://www.abajournal.com/news/article/eeoc_overusing_background_checks_may_lead_to_discrimination/.

63. See Complaint at 1, *Hudson v. First Transit*, 2010 WL 2939906 (N.D.Cal. July 20, 2010) No. C 10-03158 WHA; Complaint at 2, *Arroyo et. al v. Accenture L.P.*, 2010 WL 1606504 (S.D.N.Y. April 8, 2010) No. 10CTV3013.

nal history reviews and have little control over which employees are excluded as a result.

II. THE SECURITIES INDUSTRY & THE FINGERPRINT RULE

Like many industries in the United States, the securities industry is regulated by the federal government.⁶⁴ Therefore, employers in the securities industry are not only bound by the federal laws applicable to all U.S. employers, but they are also subject to specialized laws and regulations applicable to their industry. This federal oversight of the securities industry plays an essential role in ensuring the U.S. financial markets operate as fairly and efficiently as possible.⁶⁵ However, it also imposes a unique set of challenges and obligations on employers in the securities industry.

A. *Background on the Securities Industry*

Congress passed the Securities Exchange Act of 1934 and created the SEC in response to the stock market crash of 1929.⁶⁶ Since the 1930s, the SEC has been responsible for regulating the U.S. stock markets, the firms and individuals who trade on those markets, and the companies that list their stocks on a stock exchange.⁶⁷ The Securities and Exchange Act of 1934 gave the SEC the power to promulgate regulations to ensure a fair and equitable marketplace.⁶⁸ To aid enforcement, the SEC has delegated certain regulatory obligations to the stock exchanges.⁶⁹ As self-regulatory organizations, the individual stock exchanges and independent regulatory organizations can enforce the SEC regulations on market participants and are subject to oversight by the SEC.⁷⁰

The securities markets themselves have changed dramatically since 1934. As a result, the SEC has been faced with the challenge of adapting its rules so as to remain applicable to the evolving market structure while also

64. SEC, *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity and Facilitates Capital Formation* (Modified Oct. 20, 2010), <http://www.sec.gov/about/whatwedo.shtml>.

65. *Id.*

66. Khandemian, Anne M., *The Securities and Exchange Commission: A Small Regulatory Agency with a Gargantuan Challenge*, 62 PUB. ADMIN. REVIEW 5, 515-16 (Sept./Oct. 2002); SEC, *supra* note 64.

67. *Id.*

68. *Id.*

69. See 15 U.S.C. § 78o-3 (2006).

70. See § 78o-3; SEC Concept Release Concerning Self-Regulation, 60 Fed. Reg. 71256 (Dec. 8, 2004).

continuing to maintain a fair and efficient marketplace.⁷¹ For example, in 1975 Congress amended the Securities Exchange Act of 1934 and encouraged the SEC to modify its regulations to facilitate the growth of multiple stock exchanges, to encourage competition, and to ensure customers received the best possible prices.⁷² Consequently, the number of trading facilities available to people has exploded over the past three decades as technology and competition have increased, and the stock markets have shifted primarily to electronic trading.⁷³ Today, it is estimated that over 70 percent of volume on U.S. stock markets is generated electronically.⁷⁴

B. Rule 17f-2: The Fingerprint Rule

Section 15(b)(4)(1) of the Securities and Exchange Act obligates the Securities and Exchange Commission to restrict the activities of broker-dealers and their employees who are statutorily disqualified.⁷⁵ An individual can become statutorily disqualified for violating SEC or exchange rules, the rules of the Commodity Futures Trading Commission, or the rules of several other governmental or regulatory bodies.⁷⁶ More significantly, employees can be disqualified if they have been convicted of a felony or misdemeanor involving the “purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, . . . conspiracy to commit any such offense; larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds, or securities,”⁷⁷ or any other felony in the previous ten years.⁷⁸ The language of this Act is so expansive that an individual convicted of shoplifting at eighteen could be statutorily disqualified from working in the securities industry until the age of twenty-eight.⁷⁹

Although quite broad, the prohibited offenses recognize the importance of the having trustworthy employees in positions that involve handling important financial instruments. One of the SEC’s main functions

71. See SEC Concept Release on Equity Market Structure 75 Fed Reg. 3594, 3596 (January 21, 2010); Maureen O’Hara, *Searching for a New Center: U.S. Securities Markets in Transition*, ECONOMIC REVIEW 37, 38 (Fed. Res. Bank of Atlanta, Fourth Quarter 2004).

72. O’Hara, *supra* note 71, at 38.

73. See SEC Concept Release on Equity Market Structure, *supra* note 71, at 3,594.

74. Randall Dodd, *Opaque Trades*, 47 INTERNATIONAL MONETARY FUND FINANCE AND DEVELOPMENT 26, 27 (March 2010).

75. 15 U.S.C. § 78o(b)(4) (2006).

76. 15 U.S.C. § 78c(a)(39)(F).

77. § 78o(b)(4).

78. § 78c(a)(39)(F).

79. See § 78c(a)(39)(F); § 78o(b)(4).

is to protect investors so they feel comfortable investing their money in the stock market and contributing to an efficient marketplace.⁸⁰ This is an extremely important task. Therefore, it is certainly understandable that the SEC would restrict broker-dealers from hiring individuals convicted of crimes involving theft or fraud for positions which require handling cash and securities, just as it would be understandable not to hire a person convicted of theft for a position such as a bank teller or cashier, which requires handling significant amounts of cash.

The SEC established the fingerprinting rule to address the obligations imposed by Section 15(b)(4)(1) of the Securities and Exchange Act. Under the fingerprint rule, a broker-dealer or member of a securities exchange must fingerprint all of their associated persons,⁸¹ unless subject to an exemption.⁸² The employer must also submit those fingerprints to the Attorney General, or his designee, for a criminal history check.⁸³ If an individual's criminal history check uncovers arrests or criminal conviction records, the details of those arrests are reported back to the broker-dealer.⁸⁴ The broker-dealer uses the results of the criminal history report to determine whether employing the individual would be a violation of Section 15(b)(4)(1).⁸⁵ Additionally, the fingerprint rule sets out the following three limited exemptions to excuse employees from the fingerprint requirement: (1) individuals who are not engaged in the sale of securities; (2) individuals who do not regularly have access to the handling or processing of securities, money, or the original books and records relating to securities or money; and (3) individuals who are not responsible for the supervision of the activities described in the other exceptions.⁸⁶

The requirements of the fingerprint rule seem to encourage employers to underutilize the exemptions. First, the rule requires that broker-dealers follow specific procedures with respect to any employee deemed to be exempt from the fingerprinting requirement. The broker-dealer must maintain a notice of exemption listing each employee for which it is claiming the exemption, including detailed information about the job functions of each exempt employee and the procedures taken to ensure the exempt em-

80. SEC, *supra* note 64.

81. For purposes of this note, associated persons include officers, directors, partners, and employees.

82. 17 C.F.R. § 240.17f-2 (2010).

83. § 240.17f-2.

84. National Association of Securities Dealers, Notice to Members 05-39: Fingerprinting Procedures, 1 (May 2005)
<http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p014265.pdf>.

85. *Id.* at 2.

86. § 240.17f-2(a)(1).

ployee does not have access to any books and records relating to securities or money.⁸⁷ Further, the broker-dealer must maintain these exemption notices for the life of the company.⁸⁸

Second, failing to fingerprint someone who does not qualify for an exemption can be a costly risk many employers may be unwilling to take. Broker-dealers who fail to comply with the fingerprinting requirement of the SEC may be subject to regulatory action from the SEC or any self-regulatory organization that conducts examinations of the broker-dealer.⁸⁹ In recent years, firms have been fined between \$10,000 and \$15,000 for failing to fingerprint all necessary employees.⁹⁰ Broker-dealers need to be diligent about submitting fingerprint records for all necessary employees because of the significant fines that are assessed for violations of the fingerprint rule and because subsequent violations could result in even higher penalties.⁹¹ Furthermore, trading firms want to be cautious in their evaluation of which positions fall within the requirements of the rule. While an employer may reasonably believe an employee qualifies for an exemption, the broker-dealer could be subject to a fine if the self-regulatory organization conducting their examination interprets the rule differently.⁹²

If an employee's fingerprint results reveal a conviction that would statutorily disqualify the individual, the employer is not flatly prohibited from continuing to employ the person. The self-regulatory organizations provide a process through which broker-dealers can request permission for a statutorily disqualified employee to work in the industry.⁹³ However,

87. § 240.17f-2(e)(1)

88. 17 C.F.R. § 240.17a-4(e)(3).

89. See, e.g., Chicago Board Options Exchange Business Conduct Committee Decision Accepting Offer of Settlement, Nolita Capital 10-0022 (Aug. 17, 2010), <https://www.cboe.org/publish/DisDecision/10-0022.pdf> (assessing fine of \$12,500 for failure to fingerprint employees); National Association of Securities Dealers, *Notice to Members Disciplinary Actions and Other Decisions* 5 (May 2007) (assessing Geneos Wealth Management a fine of \$15,000 for failure to fingerprint).

90. See Chicago Board Options Exchange Business Conduct Committee *supra* note 89; Chicago Board Options Exchange Business Conduct Committee Decision Accepting Offer of Settlement, Cassandra Trading 10-0017 (May 25, 2010), <https://www.cboe.org/publish/DisDecision/10-0017.pdf> (assessing fine of \$15,000 for failure to fingerprint employees); Chicago Board Options Exchange Business Conduct Committee Decision Accepting Offer of Settlement, Wolverine Trading LLC, 08-0053 (Dec. 18, 2008), <https://www.cboe.org/publish/DisDecision/08-0053.pdf> (assessing fine of \$10,000 for failure to fingerprint); National Association of Securities Dealers, *supra* note 89.

91. Regulators generally assess higher fines for repeated violations of the same rule in order to deter future violations. See Financial Industry Regulatory Authority, Sanction Guidelines 2 (2010), <http://www.finra.org/web/groups/industry/@ip/@enfi/@sg/documents/industry/p011038.pdf>.

92. For fines relating to failure to fingerprinting employees, see Chicago Board Options Exchange Business Conduct Committee *supra* note 89; National Association of Securities Dealers, *supra* note 89.

93. Financial Industry Regulatory Authority (FINRA) Rule 9522(e)(2), SR-NASD-97-28 (Effective Aug. 1997); FINRA Rule 9523, SR-NASD-99-76 (Effective Sept. 11, 2000).

there is little incentive for employers to subject themselves to the complex authorization process to retain a statutorily disqualified individual. The process requires application to the appropriate self-regulatory organization, including a possible hearing on the matter, is subject to the discretion of the self-regulatory organization, and if approved, requires the employer to institute special supervision requirements with respect to the employee in question.⁹⁴ The Financial Industry Regulatory Authority (FINRA), one of the primary self-regulatory organizations in the securities industry, reports only eleven statutory disqualification decisions in the past four years relating to individuals with criminal histories.⁹⁵ In nine of those decisions, FINRA did authorize the employee to work for a broker-dealer subject to heightened supervision requirements specified by FINRA.⁹⁶ FINRA denied the two other applications requesting approval to work despite a statutory disqualification.⁹⁷ As the rule currently stands, the best alternative for employers is to fingerprint nearly all employees and refuse to hire anyone deemed statutorily disqualified.

94. Financial Industry Regulatory Authority (FINRA) Rule 9522(e)(2), SR-NASD-97-28 (Effective August 1997); FINRA Rule 9523, SR-NASD-99-76 (Effective Sept. 11, 2000).

95. See FINRA National Adjudicatory Council Decision SD08001 (2008), <http://www.finra.org/web/groups/industry/@ip/@enfi/@adj/documents/nacdecisions/p117871.pdf>; FINRA National Adjudicatory Council Decision SD07003 (2007), <http://www.finra.org/web/groups/industry/@ip/@enfi/@adj/documents/nacdecisions/p037826.pdf>; FINRA National Adjudicatory Council Decision SD07001 (2007), <http://www.finra.org/web/groups/industry/@ip/@enfi/@adj/documents/nacdecisions/p037824.pdf>; NASD National Adjudicatory Council Decision SD06015 (2006), <http://www.finra.org/web/groups/industry/@ip/@enfi/@adj/documents/nacdecisions/p036488.pdf>; NASD National Adjudicatory Council Decision SD06012 (2006), <http://www.finra.org/web/groups/industry/@ip/@enfi/@adj/documents/nacdecisions/p036477.pdf>; NASD National Adjudicatory Council Decision SD06011 (2006), <http://www.finra.org/web/groups/industry/@ip/@enfi/@adj/documents/nacdecisions/p036486.pdf> ; NASD National Adjudicatory Council Decision SD06010 (2006), <http://www.finra.org/web/groups/industry/@ip/@enfi/@adj/documents/nacdecisions/p036485.pdf>; NASD National Adjudicatory Council Decision SD06009 (2006), <http://www.finra.org/web/groups/industry/@ip/@enfi/@adj/documents/nacdecisions/p036484.pdf> ; NASD National Adjudicatory Council Decision SD06006 (2006), <http://www.finra.org/web/groups/industry/@ip/@enfi/@adj/documents/nacdecisions/p036483.pdf>; NASD National Adjudicatory Council Decision SD06005 (2006), <http://www.finra.org/web/groups/industry/@ip/@enfi/@adj/documents/nacdecisions/p036482.pdf>; NASD National Adjudicatory Council Decision SD06002 (2006), <http://www.finra.org/web/groups/industry/@ip/@enfi/@adj/documents/nacdecisions/p036476.pdf>.

96. See FINRA National Adjudicatory Council Decision SD08001, *supra* note 95; FINRA National Adjudicatory Council Decision SD07003, *supra* note 95; FINRA National Adjudicatory Council Decision SD07001, *supra* note 95; NASD National Adjudicatory Council Decision SD06015, *supra* note 95; NASD National Adjudicatory Council Decision SD06011, *supra* note 95; NASD National Adjudicatory Council Decision SD06010, *supra* note 95; NASD National Adjudicatory Council Decision SD06009, *supra* note 95; NASD National Adjudicatory Council Decision SD06006, *supra* note 95; NASD National Adjudicatory Council Decision SD06005, *supra* note 95.

97. See NASD National Adjudicatory Council Decision SD06012, *supra* note 95; NASD National Adjudicatory Council Decision SD06002, *supra* note 95.

C. *Application of the Fingerprint Rule*

The fingerprint rule was enacted in 1982 and, although the industry has since shifted to a heavily electronic environment,⁹⁸ the rule has remained essentially unchanged since first enacted.⁹⁹ The rule seems to be outdated in today's modern environment. Presume, for example, that a twenty-six-year-old African American man wishes to apply for a job as a computer programmer at a New York City trading firm. He has a college degree in computer programming and several years of relevant experience working as a computer programmer in another industry. Suppose that this young man was convicted of theft at eighteen years old, but has not had any legal problems since high school. At first glance, this young man may look like an ideal candidate for some employers in the securities industry.

Unfortunately for this young job applicant, his criminal conviction places the broker-dealer in a predicament. The electronic evolution of the securities markets not only changed the market structure, but also vastly altered the job functions of employees at broker-dealers. Previously, an employer could easily identify who had a key to the safe or a filing cabinet. However, employers may no longer be able to easily determine which computer programmers on staff might be viewed as having access to books and records.

When a trading system functions completely electronically, a firm might have certain programmers who create and maintain the systems that decide to send the order to purchase stock, other programmers who create and maintain the systems which translate those orders into the programming language used by a particular stock exchange, other programmers who maintain the database which stores all the trading data the firm is obligated to retain, and still other programmers who design and run trading reports to assist management in monitoring trading behavior. Likewise, information technology personnel, who are responsible for resolving equipment issues, may also have access to systems containing trade data. All such employees could be said to have access to books and records relating to securities or monies and therefore may be subject to the fingerprint rule.¹⁰⁰ Yet, the job roles described above could easily encompass most of the departments in a trading firm.

98. See Pankaj K. Jain, *Financial Market Design and the Equity Premium: Electronic versus Floor Trading*, 60 JOUR. FIN. 2955, 2965 (2005) (stating that most exchanges now operate fully electronically).

99. 17 C.F.R. § 240.17f-2 (2010).

100. See *id.*

Unfortunately, trading firms may be forced to reject this hypothetical job applicant, solely on the basis of his criminal conviction, because any computer programming position the applicant could be hired for would likely involve accessing the firm's "books and records relating to securities and monies."¹⁰¹ Employers are left with few alternatives even if it is clear that the job applicant is not a risk to the firm or its customers. The employer can reject the otherwise qualified applicant, try to create a job role that she is confident would be exempt under the fingerprint rule and maintain the necessary exemption paperwork for the employee, or apply for authorization from her self-regulatory organization to employ the statutorily disqualified person. Unfortunately for job applicants with criminal backgrounds, the least burdensome option for the employer is to simply reject the applicant and look for another candidate without a criminal history.

Broker-dealers are placed in a situation that encourages them to comply with the fingerprint rule in an overly broad manner because the SEC's fingerprint rule has not evolved along with the technological changes in the industry. This is especially true since the language of 17f-2 provides ample room for interpretation as to what constitutes access to the books and records, monies, or securities.¹⁰² Moreover, the SEC discourages narrow application of the rule by placing the burden on employers to justify to their regulator why an individual is exempt.¹⁰³ An employer may reasonably believe that her receptionist clearly falls within the exemption to the rule and therefore would not be required to be fingerprinted.¹⁰⁴ However, if the receptionist's responsibilities include opening business-related mail, then the employee may be subject to the fingerprinting rule.¹⁰⁵

Further, even if the employer is confident that certain job functions are justifiably exempt from the fingerprint requirement, the employer is still faced with the burden of maintaining the appropriate documentation to defend the exemption.¹⁰⁶ The employer must keep its exemption notices updated for any employees it opts not to fingerprint and must ensure that employees are subsequently fingerprinted if their job responsibilities change such that they become subject to the rule.¹⁰⁷ Employers are encouraged to submit fingerprints for nearly all employees and to refuse to em-

101. § 240.17f-2(a)(1).

102. See § 240.17f-2(a)(1)(i).

103. See § 240.17f-2(a)(1); § 240.17f-2(e).

104. See § 240.17f-2(a)(1).

105. *Id.*

106. § 240.17f-2(e).

107. See § 240.17f-2(a)(1); see also § 240.17f-2(e).

ploy anyone that is statutorily disqualified because of the burden created by the fingerprinting rule.

III. THE FINGERPRINT RULE'S POTENTIAL DISPARATE IMPACT ON MINORITIES

Not only are the procedural matters involved with the fingerprint rule a burden to employers in the securities industry, but complying with the rule may also subject the employer to Title VII liability. The EEOC's recommendations for employers using criminal background checks as an employment screening practice are aimed at avoiding the disparate impact such practices can have on African Americans and Hispanics.¹⁰⁸ Yet, as discussed above, the SEC's fingerprint rule provides few alternatives for employers in the securities industry. The required use of criminal background checks in the securities industry, the low employment rates for African Americans and Hispanics in the securities industry,¹⁰⁹ and the high criminal conviction rates amongst these populations¹¹⁰ give rise to an inference that the fingerprint rule may have a disparate impact on minorities. Additionally, the technological changes that have occurred over the past three decades in the securities industry have likely weakened any argument that the fingerprint requirement meets the standards for a business necessity defense,¹¹¹ or that an alternative non-discriminatory method of screening is unavailable.¹¹²

Further, employers in the securities industry may believe that they would be protected from Title VII liability since the fingerprinting requirement is an SEC regulation with which they must comply. While that may garner some sympathy and understanding from the courts, it is not likely to provide employers a complete defense to Title VII liability. Fortunately, the SEC is in the position to relieve the burden the fingerprint rule places on employers by narrowing the scope of the rule so it better suits how the industry operates in today's electronic environment.

108. See EEOC, *supra* note 46; EEOC, *supra* note 38, at 1.

109. See Bureau of Labor Statistics, *Current Population Survey*, (focusing on table 18) (Dept. of Labor 2010) (noting that African-Americans and Hispanics combined hold less than 10 percent of job positions in the securities industry).

110. See Bureau of Justice Statistics, *supra* note 14.

111. 42 U.S.C. § 2000e-2(k)(1)(A)(i) (2006).

112. § 2000e-2(k)(1)(A)(ii).

A. *Adverse Impact on Minorities*

To establish an adverse impact on a protected class of people, a plaintiff must identify the employment practice at issue and demonstrate the connection between the practice and the adverse impact on the protected class.¹¹³ An adverse impact may be suggested when the percentage of minorities employed in the jobs at issue is significantly disproportionate to the percentage of minorities in the surrounding community.¹¹⁴ The Third Circuit upheld a district court's finding that a residency requirement caused an adverse impact because the percentage of minorities hired was extremely low as compared to the minority population in the local geographic area.¹¹⁵ While statistical evidence from the actual pool of applicants or qualified labor pool may best demonstrate the connection between the employment practice and the adverse impact, such evidentiary support may not always be available to demonstrate a direct correlation between the employment practice and its adverse impact on minority groups.

With respect to the securities industry, the percentage of minorities employed in the industry is significantly disproportionate to the available labor pool. The current population survey for 2010 found that African Americans and Hispanics comprise only 5.3 and 4.6 percent of job positions, respectively, in the securities, commodities, funds, trust, and other financial investments categories.¹¹⁶ Over 80 percent, or four-fifths, of job positions in the securities industry are filled by white or non-minority persons.¹¹⁷ In comparison, in New York City, the financial center of U.S. securities markets, African Americans comprised 26.6 percent of the population and Hispanics comprised 27 percent of the overall population as of 2006.¹¹⁸ Although the entire minority population is not necessarily representative of the qualified labor pool for the securities industry and New York City serves as only one example of a relevant population, the statistics do provide insight into the dramatic disparity between the representa-

113. *Lewis v. City of Chicago*, 130 S. Ct. 2191, 2197 (2010); *Ricci v. DeStefano*, 129 S. Ct. 2658, 2673 (2009).

114. *See Newark Branch, N.A.A.C.P. v. Town of Harrison, N.J.*, 940 F.2d. 792, 799–801 (3d Cir. 1991). Generally, the evaluation of the statistical disparity focuses specifically on the relevant labor market. *Id.* at 798.

115. *Id.* To support its holding, the court stated that “[i]t would be hard to conclude that among the very substantial number of black workers in the four county labor market there are not a large number of persons qualified to serve as police officers, fire fighters, clerk typists and laborers.” *Id.* at 799.

116. Bureau of Labor Statistics, *supra* note 109.

117. Asian employees comprise 8.0 percent of positions bringing the total for all three minority racial groups to 17.9 percent. *Id.*

118. U.S. Census Bureau, State and County Quick Facts New York (city), NY (Modified Aug. 16, 2010), <http://quickfacts.census.gov/qfd/states/36/3651000.html>.

tion of these minority groups in a relevant population and their representations in the securities industry.

Further, the lack of minorities in professional or management positions in the industry is striking. The majority of positions in the financial services industry are professional and management level.¹¹⁹ Yet, in the securities industry, African Americans comprise only 4.4 percent of official or management positions and only 7 percent of professional positions.¹²⁰ Similarly, Hispanic employees represent only 2.9 percent of official or management positions and only 4.4 percent of professional positions.¹²¹

The limited presence of minorities in the financial services industry has even garnered the attention of Congress. In May 2010, Orice Williams Brown, the Director of the Government Accountability Office's (GAO) Financial Markets and Community Investment Team, testified before the Subcommittees on Oversight and Investigations and Housing Community Opportunity and the House Committee on Financial Services about the GAO's study on management-level diversity in the financial services industry.¹²² Mr. Brown testified that although many financial services firms initiated diversity programs in the mid-1990s, there has not been any significant change in diversity in management positions in the financial services industry.¹²³ Recruitment and retention issues were noted as contributing factors for the lack of minorities in management-level positions.¹²⁴ It seems logical that few minorities would have the opportunity for promotion into management-level positions given that they hold so few positions within the industry overall. Increasing the presence of minorities in the industry overall would likely facilitate their increased presence in management positions.

Ultimately, these statistics should raise questions as to whether the use of criminal background checks as an employment screening tool in the securities industry has an adverse impact on African Americans and Hispanics due to the prevalence of criminal convictions in those communities. The Bureau of Justice Statistics reports that per every 100,000 people, the imprisonment rate for African American men is 3,161 and for Hispanic

119. EEOC, *DIVERSITY IN THE FINANCIAL INDUSTRY* 3 (2006).

120. *Id.* at 7.

121. *Id.* at 8.

122. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-736T, *FINANCIAL SERVICES INDUSTRY: OVERALL TRENDS IN MANAGEMENT-LEVEL DIVERSITY AND DIVERSITY INITIATIVES, 1993-2008*, 1, 3 (May 12, 2010).

123. *Id.* at 7-10.

124. *Id.* at 11-12.

men the rate is 1,200 as compared to 487 for white men.¹²⁵ These numbers reflect incarceration rates that are nearly 6.5 and 2.5 times higher for African American and Hispanic men, respectively, as compared to white men. Moreover, these figures demonstrate the increased likelihood for an African American or Hispanic man to have a criminal conviction as compared to a white man. With minority populations rapidly increasing as a percentage of the overall population in the United States,¹²⁶ the fact that their representation in the securities industry remains extremely low raises an inference that African Americans and Hispanics are adversely impacted by an employment practice that excludes individuals based on criminal convictions.¹²⁷

B. The Fingerprint Rule is Too Broad to Support a Business Necessity Defense.

The evolution of the securities markets to an electronic trading environment and the broad application of the fingerprint rule no longer support a business necessity defense. When the SEC first enacted the fingerprint requirement in 1982,¹²⁸ the job roles to which the fingerprint rule applied were likely apparent and logical. Traders worked on the exchange floor and manually completed trading cards to document their transactions.¹²⁹ Generally, customers deposited money into their brokerage accounts by cash or check.¹³⁰ Representatives often received customer orders via phone and manually documented those transactions.¹³¹ Stock certificates were physically transferred via messenger¹³² and held for safekeeping by the firm in a

125. Bureau of Justice Statistics, *supra* note 14.

126. U.S. Census Bureau, *Overview of Race and Hispanic Origin: 2010*, 2010 CENSUS BRIEFS 4 (March 2011).

127. Additional factors may also contribute to the low presence of minorities in the securities industry. A history of direct discrimination may contribute to lingering attitudes in hiring decisions. See Halah Touryalai, *Our Diversity Problem*, REGISTERED REPRESENTATIVE (Mar 1, 2006), http://registeredrep.com/mag/finance_diversity_problem. Additionally, lack of participation in the industry overall may be indicative of limited knowledge about the industry and may also lead to fewer employment opportunities as financial professionals tend to reach out most often to persons similar to themselves. See Louise Marie Roth, *Bringing Clients Back In: Homophily Preferences and Inequality on Wall Street*, 45 SOCIOLOGY QUARTERLY 613, 621 (2004); GREGORY S. BELL, *IN THE BLACK: A HISTORY OF AFRICAN-AMERICANS ON WALL STREET* 4–5 (John Wiley & Sons, Inc. 2002).

128. 17 C.F.R. § 240.17f-2 (2010).

129. VIRGINIA B. MORRIS & STEWARD Z. GOLDSTEIN, *GUIDE TO CLEARANCE AND SETTLEMENT* 5 (Light Bulb Press 2009).

130. See Geoffrey R. Gerdes & Jack K. Walton II., *The Use of Checks and Other Non-Cash Payment Instruments in the United States*, FED. RES. BULLETIN 360 (August 2002) (nothing that check use in the United States has declined since the mid-1990s as electronic transactions have increased).

131. See LARRY HARRIS, *TRADING AND EXCHANGES: MARKET MICROSTRUCTURE FOR PRACTITIONERS* 147 (Oxford Univ. Press 2003).

132. MORRIS & GOLDSTEIN, *supra* note 129, at 4.

vault or safe.¹³³ Trading cards, checks, cash, and stock certificates are valuable items and anyone handling them needed to be trustworthy. Employers could almost certainly make the case that the fingerprint rule was a business necessity to protect customer and firm money and to ensure that the securities, monies, and books and records handled by these employees remained safe.

However, as discussed above, the fingerprint rule can be interpreted as applying to nearly all job functions at a trading firm in today's electronic environment. The transition to an electronic workplace has broadened the number of positions that interact with trade information while also facilitating electronic safeguards to prevent against the misappropriation of valuables or information. The clearance and settlement of securities involves the electronic transfer of stock between firms through the clearing organizations and no longer requires the physical delivery of stock certificates.¹³⁴ Likewise, transferring money between bank accounts or customer trading accounts is now primarily done in an electronic fashion.¹³⁵ As a result, trading firms rarely handle cash or physical stock certificates.¹³⁶ Trading firms are able to limit access to funds and to require multiple levels of approval for transfers between accounts through the use of electronic controls.¹³⁷ Electronic order entry, by customers or firms, takes much of the trading responsibility away from the individual trader in exchange for a more standardized and controlled format.¹³⁸ Further, customers and management have near real-time access to account information to verify that activity in trading accounts is consistent with their requests.¹³⁹ With all the changes that have occurred in the industry, a broker-dealer would have difficulty establishing the business necessity of criminal background checks for every job role at a trading firm.

133. DOUGLAS W. KURTZ & DAWN K. RHODES, *POLICIES AND PROCEDURES MANUAL FOR ACCOUNTING AND FINANCIAL CONTROL* 133–134 (Prentice Hall 1992).

134. MORRIS & GOLDSTEIN, *supra* note 129, at 5.

135. See FEDERAL RESERVE BOARD SYSTEM, *THE ELECTRONIC PAYMENT STUDY: A SURVEY OF ELECTRONIC PAYMENTS FOR THE 2007 FEDERAL RESERVE PAYMENTS STUDY* 18, 21 (March 2008) (finding the number of automated clearing house transactions, such as direct deposits, electronic checks, and electronic bill payment, increased 18.6 percent to 14.6 billion between 2003 and 2006).

136. See MORRIS & GOLDSTEIN, *supra* note 129, at 7.

137. KURTZ & RHODES, *supra* note 133, at 13.

138. See Brad M. Barber & Terrance Odean, *Online Investors: Do the Slow Die First*, 15 REV. FIN. STUDIES 455, 461 (2002) (stating that online investment systems allow customers to place orders without a broker serving as an intermediary and such systems give customers a greater sense of control).

139. See Hans R. Stoll, *Electronic Trading in Stock Markets*, 20 JOUR. OF ECON. PERSPECTIVES 167 (Winter 2006).

To maintain a strong business necessity defense, the EEOC recommends that employers evaluate the use of criminal background checks in terms of the type of job and the nature and seriousness of the offense.¹⁴⁰ The securities industry's application of the fingerprint rule is hardly limited in this respect given the plethora of crimes included in the definition of statutory disqualification. A wide range of offenses are covered by the statutory language, including misdemeanors involving larceny, theft, robbery, extortion, forgery, or embezzlement,¹⁴¹ and any felony in the past ten years.¹⁴² While serious offenses on their face, one could imagine how a conviction for misdemeanor theft could be a misunderstanding or mistake from which the individual has learned. Likewise, a felony conviction for a crime completely unrelated to dishonesty or theft, such as felony driving under the influence or drug possession, may be evidence of a past personal issue for the individual, but not necessarily a reflection of their ability to be a competent employee. Moreover, the past conviction may have led the employee to seek treatment for their issues and may not represent their current state of recovery. A broad exclusion based on past criminal convictions does not provide employers the opportunity to make individualized judgments about their employees.¹⁴³ Employers would be in a stronger position to demonstrate their compliance with Title VII if the SEC allowed the employers more flexibility to evaluate the specific facts and circumstances of an individual's criminal history when making an employment decision.

Despite the EEOC's recommendations that employers consider the seriousness of the offense and the length of time since the offense occurred,¹⁴⁴ there is little the SEC can do to limit the offenses covered or the ten-year timeframe because those were set by Congress in the Securities Exchange Act.¹⁴⁵ However, the SEC's inability to limit the applicable offenses or timeframe makes it even more important that the SEC narrowly tailor the rule to apply only to the job functions where a criminal conviction would create an unacceptable level of risk for the broker-dealer.

The EEOC also recommends that employers frequently reevaluate the relevance of a background check requirement as job roles evolve.¹⁴⁶ The securities industry is not the same business it was in 1982, but the rule re-

140. EEOC, *supra* note 46.

141. 15 U.S.C. § 78o(b)(4) (2006).

142. 15 U.S.C. § 78c(a)(39)(F) (2006).

143. *See* EEOC, *supra* note 46.

144. *Id.*

145. *See* § 78o(b)(4); § 78c(a)(39)(F).

146. EEOC, *supra* note 38, at 5.

mains unchanged. As a result, the rule has essentially swallowed the exemptions and created a requirement that nearly all personnel be subject to a criminal background check.¹⁴⁷

Finally, Title VII provides that a business necessity defense can be overcome by demonstrating there is an alternative, less discriminatory method that can achieve the same business-related result.¹⁴⁸ The current application of the rule leaves employers vulnerable to arguments about less discriminatory alternatives, many of which place additional, unnecessary burdens on the employers. For example, an employer that wishes to avoid Title VII liability could structure her trading systems and processes to ensure that a number of job roles have no access to any data that would fall within the requirements of the rule. However, this may require the employer to restructure how departments or computer networks operate. The employer also may need to restrict the non-fingerprinted employees' access to firm computer systems so as to avoid the possibility of unintended access to information. Further, the employer may need to refrain from assigning specific tasks to the individuals she has decided not to fingerprint. In addition to the logistical problems this decision could create, the employer would be obligated to maintain proper documentation to demonstrate the exemption from the fingerprint rule is valid.¹⁴⁹

C. The Regulatory Requirement Defense

The issue of whether the fingerprint requirement causes a disparate impact under Title VII has not yet become a large issue for the securities industry. Employers might assume that the judicial system would not hold them liable for something they are required by a federal agency to do. Certainly, employers in the securities industry are not alone in facing the predicament of conflicting regulatory obligations being imposed by separate agencies of the federal government.¹⁵⁰ While federal agencies are encour-

147. See 17 C.F.R. § 240.17f-2 (2010).

148. *El v. Se. Pa. Transp. Auth.*, 479 F.3d 232, 240–241 (3d Cir. 2007).

149. § 240.17f-2(e)(1).

150. See Letter from Senators Maria Cantwell and Patty Murray and Congressmen Adam Smith, Dave Reichert, Jay Inslee, and Jim McDermott to Army Corps of Engineers (June 7, 2010), http://cantwell.senate.gov/news/060710_Army_Corps_Levee_Letter.pdf (regarding new rules prohibiting vegetation on levees which could create Endangered Species Act issues for several Washington area communities).

aged to evaluate the potential for conflict prior to enacting rules,¹⁵¹ conflicting agency regulations continue to cause problems.¹⁵²

Unfortunately, there is no efficient federal process to resolve conflicting regulatory obligations.¹⁵³ These conflicts may occur because the inconsistencies are not readily apparent until the regulations are implemented or, as in the case of the fingerprint rule, because the conflict arises as a result of changes in the applicable industry. Those subject to the conflicting regulations often remain trapped by interagency conflicts until Congress acts, one of the agencies amends their regulations to undo the existing conflict, or an individual case reaches the judicial system so that the courts can weigh in on the matter.¹⁵⁴ In evaluating agency action, courts are hesitant to overturn agency decisions but will do so if the agency failed to consider an important aspect of the problem.¹⁵⁵

There is no federal regulation prohibiting use of criminal background checks in employment decisions or specifying how Title VII applies to these policies. While the fingerprint rule is a regulation promulgated by the SEC, in contrast, the EEOC guidance on criminal background checks is only an agency interpretation as to what may constitute a disparate impact under Title VII. The courts have not directly spoken as to whether broad use of criminal background checks can create a disparate impact against African Americans and Hispanics. However, there are several cases currently pending that specifically address the issue.¹⁵⁶ If the courts determine that a broad practice of disqualifying job applicants based on a past criminal conviction can have a disparate impact on African Americans and Hispanics, employers in the securities industry may be faced with a regulatory obligation under the fingerprint rule that violates Title VII.

Certainly, employers in the securities industry could await a lawsuit by rejected job applicants to determine how courts would balance the regulatory obligation established by the SEC against a judicial interpretation as

151. See Exec. Order No. 13497, 74 Fed. Reg. 6113 (Feb. 4, 2009) (removing President Bush's amendments to Executive Order #12866); Exec. Order No. 12866, 58 Fed. Reg. 51735 (Oct. 4, 1993) (setting out procedures for planning and review of new and existing federal regulations).

152. See *Nat'l Ass'n of Home Builders v. Defenders of Wildlife*, 551 U.S. 644, 649 (2007) (addressing potential conflict between Clean Water Act and Endanger Species Act of 1973); Letter from Senators Maria Cantwell et al., *supra* note 152.

153. Norman L. Rave, Jr., *Interagency Conflict and Administrative Accountability: Regulation the Release of Recombinant Organisms*, 77 GEO. L. J. 1787, 1810 (1988-1989).

154. *Id.*

155. *Nat'l Ass'n of Home Builders*, 551 U.S. at 658; *Motor Vehicle Mfrs. Assn. of United States, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

156. See Complaint, *EEOC v. Freeman Companies*, *supra* note 10, at 3-4; Complaint, *EEOC v. Peplemark*, *supra* note 10, at 2; Complaint *Hudson*, *supra* note 63, at 1; Complaint, *Arroyo* *supra* note 63, at 4.

to what constitutes a disparate impact under Title VII. While the courts may have sympathy for the predicament faced by the employers in the securities industry, it is unlikely the courts would imply an exemption into Title VII for the securities industry. Presumably, the courts would wish to avoid create differing standards for different types of employers with respect to Title VII. In creating a different standard under Title VII for one industry the courts may open a Pandora's Box as other types of employers in a similar predicament would also seek an exemption for criminal background checks.¹⁵⁷ The more employers who become exempt from the disparate impact provision of Title VII, the weaker the provision would become. Further, it is unlikely that the court would relieve a broker-dealer of all liability to the injured party in the case, even if the court were sympathetic to the employer's predicament. The non-discriminatory alternatives factor in Title VII leaves broker-dealers vulnerable to creative arguments from plaintiffs about steps the employer should take to minimize the discriminatory intent of the fingerprint rule, even if most alternatives would be extremely burdensome to the employer. However, the SEC is in the position to amend the language of the fingerprint rule to bring it within the business necessity exemption of Title VII.¹⁵⁸

IV. THE SEC SHOULD AMEND THE FINGERPRINT RULE TO EASE THE BURDEN ON EMPLOYERS.

The fingerprint rule should be amended so it continues to ensure the good character and trustworthiness of employees in positions that directly handle funds and securities, without unnecessarily excluding a sub-set of African Americans and Hispanics from working in the securities industry. The SEC is responsible for ensuring the intent of Congress, as set forth in the Securities Exchange Act and other relevant laws, is carried out and adapted to the address technological changes in the market.¹⁵⁹ By re-evaluating the job functions that require fingerprinting, the SEC could limit the impact of these disqualifications to only those positions to which they are truly relevant. Additionally, the SEC could modify the language of the rule to relieve the recordkeeping burden on employers who wish to utilize the fingerprint rule's exemptions. The SEC is in the position to adapt the

157. For example, the Department of Homeland Security, banks, and transit agencies all may be subject to apparently conflicting obligations with respect to pre-employment screening.

158. See SEC, *supra* note 64 (focusing on insert *How the SEC Rule Making Process Works*). Agency responsibilities include engaging in rule making to ensure the intent of Congress continues to be carried out as technology evolves.

159. SEC, *supra* note 71.

language of the rule to bring it within the business necessity defense of Title VII and alleviate the burden on employers of determining how to comply with competing statutory and regulatory obligations.

Section (a)(1) of the fingerprint rule provides exemptions for persons who are not engaged in the sale of securities, do not regularly have access to the “keeping, handling, or processing of securities, monies or the original books and records relating to the securities or the monies,” and do not directly supervise persons engaged in the activities referred to above.¹⁶⁰ This rule addresses important concerns that individuals handling valuable items, such as money and stock certificates, are trustworthy individuals. The general intent of the rule certainly has merit, particularly with respect to employees that are charged with handling customers’ money and securities. However, the fingerprint rule must be evaluated from a new perspective in light of the technological advancements of recent decades. Any individual that physically handles cash or physical stock certificates and any employee that directly makes trading decisions should still require fingerprinting. Likewise, any individual who can access trading or bank accounts with authority to move money should continue to fall within the requirements of the rule. The securities industry should be able to establish that background checks are vital to these job roles¹⁶¹ and necessary to ensure the trustworthy performance of these jobs.¹⁶² Additionally, the securities industry’s argument that criminal background checks are a business necessity for certain jobs becomes stronger when the policy is applied in a limited fashion, as opposed to the current, broad application.¹⁶³

Further, the SEC would likely have sufficient justification to continue fingerprinting executive officers of broker-dealers. Those positions remain of particular concern in light of the scandals over the past few decades involving company management misleading investors or producing deceptive financial statements.¹⁶⁴ The argument that background checks on individuals serving in these capacities is a business necessity is certainly viable and could likely withstand a Title VII challenge.

The SEC may also wish to consider whether advisors soliciting customers and providing investment advice to the public should be required to be fingerprinted. Although these roles do not necessarily provide the em-

160. 17 C.F.R. § 240.17f-2(a)(1) (2010).

161. See *Griggs v. Duke Power Co.*, 401 U.S. 424, 436 (1971); *Lanning v. Se. Pa. Transp. Auth.*, 308 F.3d 286, 289 (3d Cir. 2002).

162. See *Watson v. Fort Worth Bank and Trust*, 487 U.S. 977, 998–99 (1988).

163. See *El v. Se. Pa. Transp. Auth.*, 479 F.3d 232, 242 (3d Cir. 2007) (finding that general or overly broad application of background check policies will not meet the business necessity standard).

164. Examples include the collapse of Enron and WorldCom.

ployees with direct access to funds or securities, an argument could be made about the importance of the creditability and trustworthiness of these individuals. This concern would rise from the reliance of the general public on the advice of these employees.

While these categories do not necessarily provide a complete list of the job roles that may justify the background check requirement, they do demonstrate the level of specificity with which the SEC should tailor the rule. In doing so, the SEC will eliminate numerous job roles from the fingerprint requirement that have no interaction with funds or physical securities.¹⁶⁵ Additionally, these changes will refocus the rule to its original intent. By dramatically narrowing the scope of the fingerprint rule, the SEC could diminish the strength of disparate impact claims against employers in the industry. Many more job roles would be available to persons with minor criminal histories and a stronger business necessity defense could be established for the positions that remain affected.

Moreover, the SEC should carefully consider comments from the securities industry prior to implementing any change. The industry will be able to provide important information about the changes that have occurred in handling and processing money and securities. Specifically, the industry can provide a detailed picture of the job functions that provide individuals with access to funds or securities or the ability to place trades, as opposed to jobs that provide only peripheral access to trade data and are not in a position to misappropriate funds or securities in any way.

Further, the SEC should consider amending the language of the rule to specify the categories of person who require fingerprinting as opposed to providing exemptions for those who will not require fingerprinting. Even if the SEC tailors the exemptions to exclude additional job roles from the requirement, employers may still feel inclined to fingerprint most employees because of the paperwork burden of justifying an exemption. Employers in the securities industry can employ hundreds or thousands of employees.¹⁶⁶ Maintaining detailed paperwork as to why each one is exempt from the fingerprint rule is not practical and employers would likely find it more efficient to continue fingerprinting all employees. By amending the language of the rule to describe which employees are required to be printed, the SEC would relieve the burden on employers of maintaining

165. Examples include, but are not limited to, administrative personnel, information technology staff, and human resources employees.

166. See *Annual Ranking of America's Largest Corporations*, FORTUNE MAGAZINE, May 23, 2011, <http://money.cnn.com/magazines/fortune/fortune500/2011/industries/187/index.html> (reporting that Charles Schwab has 12,800 employees, Franklin Resources has 7,900 employees, and KKR has 698 employees).

exemption documentation for those employees who are not required to be fingerprinted.

Finding the precise language that achieves a balance between the Congressional intent of the Securities Exchange Act, practical application for employers, and Title VII compliance will not be an easy task. However, a thorough understanding of how technology has transformed the securities industry in recent years is essential. The SEC also has the burden of ensuring the public remains confident in the individuals working at trading firms so they will continue to invest their money in the stock market or seeking guidance from financial professionals. Prior to undertaking this task, the SEC should consider how trading firms operate in the new electronic marketplace, how technology has changed the processes and functions of industry employees, how technology has provided additional controls and checks on access to money and securities, and what customers believe are important job roles to include in the rule. The SEC should then update the fingerprint rule to reflect the electronic nature of the markets and alleviate the predicament currently faced by employers in the industry.

CONCLUSION

Employers in the securities industry are caught in a catch-22. They are required by SEC Rule 17f-2 to fingerprint nearly all of their employees and disqualify individuals from employment if they have a criminal conviction for any number of misdemeanors or any felony within the past ten years. While facially such a requirement may appear valid and even a good business practice, the EEOC believes a broad policy of excluding job applicants based on criminal convictions may violate Title VII. Specifically, the EEOC believes these policies have a disparate impact on African Americans and Hispanics since these minority groups have high rates of criminal convictions. While disparate impact claims depend heavily on the facts of the specific case, employers in the securities industry certainly should be concerned about their potential liability with respect to Title VII and the SEC's fingerprint rule. Minority representation in the securities industry is so low that a valid inference can be raised as to whether the industry's fingerprinting requirement has a disparate impact on minorities in violation of Title VII.

The SEC can alleviate the potential liability that the fingerprint rule creates for employers by amending the language of the fingerprint rule to better reflect its intended purpose. Electronic trading and the use of computers for handling nearly all aspects of business have dramatically altered the job functions of trading firm employees as compared to when the fin-

gerprint rule was first enacted. The SEC should feel obligated to the employers operating in the securities industry to update the language of the fingerprint rule to bring it within the business necessity defense of Title VII's disparate impact provision. Narrowing the language of the rule will relieve the burden on employers and will contribute to diversifying the securities industry by opening up job opportunities to a wider array of people.

