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An Analysis of Recent Developments & Trends

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Summary: In an opinion letter with broad implications in the financial services industry, the Department of Labor held that the subject mortgage loan officers were exempt administrative employees.

Department of Labor Issues Opinion Letter Recognizing Mortgage Loan Officers as Exempt Administrative Employees

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For the past several years, employers in the mortgage lending industry have faced increasing litigation pressure over the decision to classify loan officers as exempt from the overtime requirements of the Fair Labor Standards Act pursuant to the administrative exemption. On September 8, 2006, the Department of Labor issued Opinion Letter FLSA2006-31, in which it confirmed that mortgage loan officers can satisfy the administrative exemption. While the Department's conclusion is of particular significance for mortgage lenders, the opinion letter will have a significant impact throughout the financial services industry and beyond.

The FLSA and the Administrative Exemption

The FLSA requires covered employers to pay certain employees overtime at a rate of one and one-half times the employee's regular rate of pay for hours worked in excess of forty per week.¹ This requirement is subject to a number of exceptions. Of particular importance to employers in the mortgage industry, the overtime requirement does not apply to employees who are employed in a bona fide administrative capacity.² In order to qualify for the administrative exemption:

1. An employee must be compensated on a salary or fee

basis at a rate of not less than \$455 per week, exclusive of board, lodging, or other facilities;

2. The employee's primary duty must be the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer's customers; and
3. The employee's primary duty must include the exercise of discretion and independent judgment with respect to matters of significance.³

A. Salary or Fee Basis

The first prong of the administrative exemption requires that the employee be compensated on a salary or fee basis at a rate of not less than \$455 per week, exclusive of board, lodging or other facilities. In its September 2006 opinion letter, the Department of Labor was asked to assume that the mortgage loan officers at issue were paid on a salary basis at a rate of at least \$455 per week. Thus, the Department did not consider this element of the administrative exemption. Compliance with the salary basis element is essential to assertion of the administrative exemption, however, and employers in the financial services industry need to ensure that their pay practices with respect to their

¹ 29 U.S.C. § 207(a).

² 29 U.S.C. § 213(a)(1). Two other exemptions have received considerable attention in the mortgage industry in recent years. In Opinion Letter FLSA2006-11 (March 31, 2006), the Department of Labor concluded that loan officers who are customarily and regularly engaged away from their employer's place of business may be considered exempt under the outside sales exemption. Employers in the mortgage industry have also asserted the "retail establishment" exemption on behalf of commissioned loan officers. 29 U.S.C. § 207(i). In two unreported decisions, however, district courts in California and Minnesota rejected the application of the Section 7(i) exemption to loan officers. *Barnett v. Washington Mutual Bank, FA*, No. C03-00753, 2004 WL 1753400 (N.D. Cal. Aug. 5, 2004); *Casas v. Conseco Fin. Corp.*, No. Civ. 00-1512, 2002 WL 507059 (D. Minn. March 31, 2002). More recently, a district court in Illinois held that the exemption could be asserted on behalf of a loan officer at a mortgage broker. *Gatto v. Mortgage Specialists of Illinois, Inc.*, No. 04C5216, 2006 WL 681063 (N.D. Ill. March 13, 2006). We expect litigation on the applicability of this exemption in the mortgage industry to continue.

³ 29 C.F.R. § 541.200(a).

continued from cover

exempt administrative employees meet this critical requirement.

An employee will be considered to be paid on a “salary basis” if the employee regularly receives each pay period, on a weekly or less frequent basis, a predetermined amount constituting all or part of the employee’s compensation, which amount is not subject to reduction because of variations in the quality or quantity of the work performed. Subject to certain exceptions, an exempt employee must receive the full salary for any week in which the employee performs any work without regard to the number of days or hours worked.⁴

Employers in the mortgage lending industry commonly seek to pay loan officers both a guaranteed salary or draw (to provide a guaranteed income stream) and a commission (to provide incentive for excellent work). Applicable regulations permit such an integrated compensation plan so long as the plan guarantees that at least \$455 will be paid each week on a salary basis.⁵ Care should be taken, however, where a “deficit” of incentive compensation earned in one period in relation to the guarantee for that period is carried forward and deducted from future incentive compensation earned in excess of the guarantee in a later period.⁶

In short, while the Department of Labor was asked to assume that the mortgage loan officers at issue were paid on a salary basis at a rate of at least \$455 per week for purposes of its September 2006 opinion letter, mortgage lenders and other financial service firms should not overlook this critical requirement with respect to loan officers, brokers, and other commissioned employees.

B. Primary Duty

The second prong of the administrative exemption requires that the employee’s primary duty must be the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer’s customers.

In a 2001 opinion letter, the Department of Labor concluded that loan officers can satisfy the “duties” prong of the administrative exemption if they perform duties such as: (1) acquiring a full understanding of the borrower’s credit history and financial goals in order to advise regarding the selection of a loan package that will fit the borrower’s needs and ability; (2) working with the borrower to create a loan package that best meets the goals of the borrower while still complying with varied and complicated lender requirements; (3) selecting from a wide

range of loan packages in order to properly advise the client; and (4) supervising the processing of the transaction to closing.⁷

In the 2004 revisions to the “white collar exemption” regulations, the Department confirmed that employees who advise the customer in the selection of a financial product generally meet the duties requirements for the administrative exemption if their duties include work such as: (1) collecting and analyzing information regarding the customer’s income, assets, investments or debts; (2) determining which financial products best meet the customer’s needs and financial circumstances; (3) advising the customer regarding the advantages and disadvantages of different financial products; and (4) marketing, servicing or promoting the employer’s financial products.⁸

Consistent with this history, the Department concluded in the September 2006 opinion letter that mortgage loan officers satisfy the duties requirement of the exemption where they: (1) collect and analyze a customer’s financial information; (2) advise the customer about the risks and benefits of various mortgage loan alternatives in light of their individual financial circumstances; and (3) advise the customer about avenues to obtain a more advantageous loan program.⁹

⁴ 29 C.F.R. §§ 541.600, 602.

⁵ 29 C.F.R. § 541.604; *see, e.g.*, U.S. DoL, W&H Div., Op. Letter No. 1382, March 2, 1995 (“genuine guarantees must be obtained clearly demonstrating that the salary is not simply part of the bonus or commission, and that no circumstances exist which would reduce it or divide it”); U.S. DoL, W&H Div., Op. Letter No. WH-129, May 4, 1971 (employee must be paid no less than minimum salary “free and clear”; employer may adopt compensation plan under which employee is guaranteed payment of salary and/or draw, plus extra commissions earned in accordance with formula that provides for payment in addition to the guarantee).

⁶ *Compare Hogan v. Allstate Ins. Co.*, 210 F. Supp. 2d 1312, 1316-17 (M.D. Fl. 2002) (where guaranteed minimum amount was paid “free and clear” in addition to commissions, fact that negative premiums caused by policy cancellations were recovered from future commission amounts in excess of guaranteed monthly minimum compensation did not undermine salary basis), *aff’d in pertinent part*, 361 F.3d 621 (11th Cir. 2004), with *Takacs v. A.G. Edwards & Sons, Inc.*, Case 3:04-cv-01852, 2006 WL 2297616, at *6-7 (S.D. Cal. Aug. 2, 2006) (construing employer’s compensation plan as allowing “draw” deduction to act “as an offset from the guaranteed salary, and not as a variable in the calculation of commissions paid,” court determined that plan “significantly differs” from one that would permissibly “ensure that a fixed weekly amount is paid to the employee [and the] commission is paid in addition to the guaranteed weekly salary”). We expect to see an increase in the number of legal challenges to various compensation plans, and *Hogan* and *Takacs* should not be considered the final word on the subject. With specific regard to *Takacs*, we anticipate further litigation on the question of whether the method used to reconcile commissions above and beyond the guarantee is *ever* material to the salary basis test when the guaranteed compensation is never, in fact, reduced. Yet to be resolved are the exact limits within which a regularly paid amount cannot be considered a salary because separately calculated incentives are paid on a cumulative basis. *See* U.S. DoL, W&H Div., Op. Letter No. WH-129, May 4, 1971 (commissions may be reconciled with salary every several weeks and the “incidental fact that the period used for the computation includes workweeks with low as well as those with high sales volume does not mean that there is a recoupment by way of offset”).

⁷ U.S. DoL, W&H Div., Op. Letter, Feb. 16, 2001.

continued from page 2

One question that has arisen with some frequency in this context is whether the fact that loan officers are typically involved in the sales process disqualifies them from the administrative exemption. In the 2004 regulations, the Department stated that “an employee whose primary duty is selling financial products does not qualify for the administrative exemption.”¹⁰ The Department explained, however, that the fact that an employee is involved in sales does not itself undermine the exemption: “[M]any financial services employees qualify as exempt administrative employees, even if they are involved in some selling to consumers. Servicing existing customers, promoting the employer’s financial products, and advising customers on the appropriate financial product to fit their financial needs are duties directly related to the management or general business operations of their employer or their employer’s customers.”¹¹ The Department emphasized at that time that its final rule “rejects the view that selling financial products directly to a consumer automatically precludes a finding of exempt administrative status” as long as “selling financial products” is not the employee’s primary duty.¹²

In its September 2006 opinion letter, the Department repeated its position that loan officers can qualify for the administrative exemption even if they engage in sales.¹³

The Department cautioned, however, that “if, based on all the facts in a particular case, a mortgage loan officer’s primary duty is selling mortgage loans, the mortgage loan officer will not qualify for the administrative exemption.”¹⁴ We anticipate that plaintiffs’ lawyers will seize on this qualification and argue that since loan officers are motivated to sell the loan packages that they design, “selling financial products” must be their “primary duty” – regardless of how much time they spend gathering and analyzing information, designing loan packages, and advising borrowers with respect to the advantages and disadvantages of various loan options. Such an argument, if accepted by the courts, would cast doubt on the viability of the opinion letter, as it is properly assumed that the loan officers in the opinion letter were also motivated to sell the benefits of the loan packages they designed.

An important consideration in determining a loan officer’s “primary duty” is that the Department specifically excluded “employees in a call center environment primarily selling financial products as ‘outbound telemarketers’” from the scope of its September 2006 opinion.¹⁵ In other words, the Department recognized the difference between an exempt loan officer responsible for gathering and analyzing information, providing advice, and making recommendations, and a non-exempt

sales person prospecting for potential customers who have not previously expressed an interest in obtaining a loan. Whether the courts will draw such a clear line between non-exempt sales personnel and exempt advisors remains to be seen.

C. Discretion and Independent Judgment

The third prong of the administrative exemption requires that the employee’s primary duty must include the exercise of discretion and independent judgment with respect to matters of significance. The exercise of discretion and independent judgment involves “the comparison and the evaluation of possible courses of conduct, and acting or making a decision after the various possibilities have been considered.”¹⁶ In 2004, the Department recognized that advising customers on the appropriate financial product to fit their financial needs “require[s] the exercise of discretion and independent judgment.”¹⁷ Thus, “a financial services employee whose primary duty is gathering and analyzing facts and providing consulting advice to assist customers in choosing among many complex financial products may be an exempt administrative employee.”¹⁸ The regulations cautioned, however, that the use of “well-established techniques or procedures described in manuals or other sources within closely prescribed limits to

⁸ 29 C.F.R. § 541.203(b).

⁹ U.S. DoL, W&H Div., Op. Letter FLSA2006-31, Sept. 8, 2006, at 2, 4-5.

¹⁰ 29 C.F.R. § 541.203(b), emphasis added.

¹¹ 69 Fed. Reg. 22146 (Apr. 23, 2004).

¹² 69 Fed. Reg. 22146 (Apr. 23, 2004). Plaintiffs’ lawyers often rely upon this argument, citing to *Casas v. Conseco*, the unreported decision issued by a federal court in Minnesota that concluded that “loan originators” were non-exempt because they had a “primary duty to sell [the company’s] lending products on a day-to-day basis” directly to consumers. 2002 WL 507059, at *9 (D. Minn. March 31, 2002) (discussed at 69 Fed. Reg. 22145). The *Casas* court considered the “administrative/production dichotomy” and concluded that loan originators were “production” employees, and therefore, non-exempt, due to their responsibilities associated with the design, creation, and sale of consumer loans. In the comments to the revised regulations in 2004, however, the Department emphasized that the “production versus staff” dichotomy should not be used as a “dispositive test” for the administrative exemption. 69 Fed. Reg. 22141. Other courts have criticized the *Casas* court’s “determinative” use of the dichotomy in its analysis of the loan originators’ exempt status. See *Carlson v. C.H. Robinson Worldwide, Inc.*, Civ. No. 02-3780, 2005 U.S. Dist. LEXIS 5677 (D. Minn., March 30, 2005) (quoting the DOL comments at *15, n.10.)

¹³ U.S. DoL, W&H Div., Op. Letter FLSA2006-31, Sept. 8, 2006, at 2, 4 & n.2, 5.

¹⁴ U.S. DoL, W&H Div., Op. Letter FLSA2006-31, Sept. 8, 2006, at 5 n.3. The term “primary duty” means the “principal, main, major or most important duty that the employee performs. Determination of an employee’s primary duty must be based on all the facts in a particular case, with the major emphasis on the character of the employee’s job as a whole.” 29 C.F.R. § 541.700(a).

continued from page 3

determine the correct response to an inquiry or set of circumstances" does not meet the "discretion and independent judgment" requirement.¹⁹

In many cases, plaintiffs from the financial services industry have argued that they do not exercise discretion because they used a software program in the performance of their job duties. The September 2006 opinion letter rejects that view: "So long as these programs do not select the mortgage loan product for the mortgage loan officer and the mortgage loan officer is still responsible for assessing the alternatives and making recommendations to the customer, the use of technological tools would not mean that the mortgage loan officer does not exercise the necessary discretion and independent judgment."²⁰ This discussion of the use of "software programs" expands upon the Department's regulation relating to the "use of manuals," in which the Department emphasized that the use of "manuals, guidelines or other established procedures" does not necessarily preclude an employee from exempt status.²¹ Such manuals and procedures provide guidance in addressing difficult or novel circumstances and thus use of such reference material would not affect an employee's exempt status.²² Likewise, a financial services employee's use of software programs and similar on-line tools should not defeat his or her status as an exempt employee, as long the employee is ultimately responsible for "assessing the alternatives" and making recommendations, based upon the exercise of independent judgment.

What This Means for Employers

The September 2006 opinion letter represents the Department of Labor's first official interpretation of the "financial services" provision in the portion of the 2004 amended regulations relating to the administrative exemption. Employers in the financial services industry should be encouraged by the Department's recognition of the exempt administrative nature of job duties such as: (1) collecting and analyzing a customer's financial information; (2) advising the customer about the risks and benefits of various alternatives in light of their individual financial circumstances; and (3) advising the customer about avenues to obtain a more advantageous financial product. Further, the Department's acknowledgement that an employee can still exercise discretion and independent judgment while using software programs to assist in the evaluation of various options should make it more difficult for plaintiffs to undermine employees' exempt status merely because they use such programs.

At the same time, mortgage lenders and other employers in the financial services industry should not assume that the September 2006 opinion letter will end the debate or even slow the tide of class action litigation against such employers. Sophisticated plaintiffs' lawyers will undoubtedly seek to distinguish their clients from the mortgage loan officers found to be exempt by the Department of Labor, meaning that the impact of the opinion will not be fully known until the courts have an opportunity to consider the opinion in the context of various factual scenarios presented in litigation.

In the meantime, employers in the financial services industry should welcome this news as a

positive development, but also as an opportunity to carefully evaluate the exempt status of their loan officers and similarly situated employees in light of the actual duties they perform.

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¹⁵ U.S. DoL, W&H Div., Op. Letter FLSA2006-31, Sept. 8, 2006, at 1. The Department also excluded mortgage loan officers who are customarily and regularly engaged away from their employer's place(s) of business (who may be considered exempt under the outside sales exemption pursuant to the Department's March 31, 2006 Opinion Letter FLSA2006-11) and loan processors.

¹⁶ 29 C.F.R. § 541.202(a).

¹⁷ 69 Fed. Reg. 22146 (Apr. 23, 2004).

¹⁸ *Id.*

¹⁹ 29 C.F.R. § 541.704.

²⁰ U.S. DoL, W&H Div., Op. Letter FLSA2006-31, Sept. 8, 2006, at 7.

²¹ 29 C.F.R. § 541.704.

²² *Id.*