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JUNE 2010 ♦ VOLUME 2, ISSUE 6

Department of Labor's Reversal Requires Creative Approach to Compensation for Mortgage Loan Officers

By Tim Watson and Barry Miller

In addition to the many other new regulations in the finance industry, mortgage lenders now also find themselves wrestling with an old employment issue that until recently had been resolved in their favor. On

March 24, 2010, the U.S. Department of Labor (DOL) announced a drastic change in the agency's views about how mortgage loan officers must be paid. During the prior administration, the DOL issued a number of opinion letters based on specific facts finding that mortgage loan officers are exempt from federal overtime pay requirements. In March, however, the DOL reversed these findings and rejected the decades-old practice of issuing opinion letters based on specific factual circumstances. Instead, the DOL issued a new "Administrative Interpretation" making the blanket statement that mortgage loan officers generally are not exempt from federal overtime pay requirements under the Administrative Exemption to overtime pay—the most common exemption ap-

plied by employers to their mortgage loan officers, in addition to many other similar positions. While the interplay of the various federal overtime exemptions can be com-

plicated, the bottom line to the DOL's new position is that many mortgage loan officers who have long been paid on a salary plus commission basis now arguably must be paid overtime pay for any hours in excess of

the 40 that they work in a week.¹ As a result, mortgage lenders are struggling to find a way to reconcile the shift in the DOL's position with the realities of the lending marketplace.

The first challenge that employers face is understanding the significance and impact of the DOL's new Administrative Interpretation. The DOL does not have the power to change federal law merely by issuing interpretive guidance, and some employers may use the courts to challenge the validity of the DOL's reversal in position. However, even if the DOL's new view is vulnerable to legal challenge, it is likely that the DOL does have the power to withdraw its prior guidance regarding mortgage loan officers, and there is little doubt that employers now have less certainty regarding the exempt status of the position

than they did before the DOL issued its Administrative Interpretation. For that reason, many employers in the mortgage lending industry that have taken the DOL's new posi-

tion at face value, are beginning to analyze how it will affect their employees.

In considering whether to shift loan officers to an overtime-eligible status, employers first need to assess the type of work that the loan officers are doing. The DOL's Administrative Interpretation leaves in tact a prior finding that loan officers may meet the "outside sales" exemption to federal overtime pay requirements, if their jobs require that they spend a significant portion of their working time engaged in sales and promotional activities outside of their employer's office. Yet, in the modern business environment, face-to-face meetings with clients and prospects have often been replaced by phone calls, e-mails and text messages. For that reason, many employers will find that their loan officers spend much of their time working the phones, online and meeting with customers in a stationary office. Even those lenders that have loan officers who spend a significant amount of their time in the field find themselves in an uncertain position because the exact amount of time that an employee must spend outside to meet the exemption remains unclear. Thus, many mortgage loan companies have begun to consider reclassifying loan officers as non-exempt and eligible for overtime compensation. This raises a number of legal and business issues that these employers must address in order to ensure the continuing profitability of the loan officer position, while steering clear of prohibitions in other provisions of the state and federal wage laws.



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Generally, an overtime-eligible employee is paid overtime pay at one-and-a-half times his “regular hourly rate.” One problem created by treating loan officers as overtime-eligible employees is that commissions and certain other incentive compensation will generally be included in the employees’ “regular rate” in calculating their overtime pay. This may create unpredictability in loan officers’ compensation and the profitability of the loans that they close. Common sense and experience reflect that loan officers generally sell and close more loans in the weeks during which they work the most hours. This can create a multiplying effect on the cost of overtime pay by driving up the hourly rate of pay during weeks in which loan officers are also working the largest number of overtime hours. This means that loan officers’ compensation for each loan closed during high volume weeks may be artificially inflated, and the profitability of those loans to the lender may decrease as a result. This dynamic may be amplified by the fact that the lending industry is inherently cyclical and prone to periodic lulls and surges in activity, with the result that a lender’s entire workforce will often be busy at the same time. Having all employees become busy at the same time may, in addition to creating a companywide spike in overtime cost, limit the lender’s ability to use creative or adaptive scheduling of employees to limit the number of overtime hours worked. Given that profit margins on mortgage loans have decreased in the current economy, many lenders view these aspects of paying overtime to loan officers as a serious business challenge.

There are many changes to a lender’s business operations that may lessen the impact of treating loan officers as overtime eligible. One such measure is to manage loan officers’ working hours and attempt to reduce the number of overtime hours worked. Lenders that have always treated the position as exempt may have had no reason to analyze or manage those employees’ efficiency in the past and allowed them to set their own schedules without much direction or oversight. Those employers may find that there are efficiencies to be gained by having managers more actively engaged in the supervision of loan officers’ day-to-day activities. However, employers must be mindful that this approach may threaten to decrease a loan officers’

level of production or encourage them to improperly under-report their working hours, creating additional potential legal exposure. Another approach would be to hire additional loan officers or supporting employees in order to spread the work over a larger number of employees. Increased staffing, of course, comes with its own costs and may lead to dissatisfaction among current employees who may see their total individual compensation reduced.

In view of the challenges posed by decreasing the number of overtime hours that mortgage loan officers work, some lenders may consider measures that they can take to design a compensation program for loan officers that preserves the profitability of the lender’s operations and increases the predictability of overtime compensation costs, while complying with the DOL’s new position regarding overtime pay requirements.

One measure that will reduce the cost of including commissions in overtime pay is to provide a significant level of hourly compensation to loan officers that is independent of loan volume, in addition to some commissions on loans sold or closed. This approach would reduce the multiplying effect of including commissions in overtime pay for busier working weeks. The exact balance between hourly compensation and commission rates that best serves to control overtime costs, while preserving appropriate incentives for employees, will vary based on the nature of each lender’s operations.

More innovative employers that are willing to more fundamentally redesign the way that loan officers are paid may move away from traditional commission formulas tied directly to production of loan volume and calculated on a week-by-week basis. For example, a lender might adopt a quarterly incentive compensation program that takes into account a variety of performance factors, such as quality of customer service, capture rates, timely documentation of transactions, and promotional activities, in

addition to overall level of production. If properly constructed, such a compensation program would allow employers to spread out incentive compensation across factors that will have less week-to-week variation than simple production and also to average incentive compensation over the weeks in each quarter in a way that blunts the multiplying effect of the week-to-week variations in activity. The design of such programs involves the balancing of a number of competing factors, including ensuring that features designed to control overtime costs do not create undue cash flow problems for employees or jeopardize the employer’s ability to recruit and retain top performers. Employers can take some of the guesswork out of the process of redesigning compensation programs through statistical analysis of historical compensation and productivity data, in order to better understand their employees’ working patterns and compensation expectations.

Employers that are proactive in responding to the DOL’s reversal in its position regarding loan officers and overtime compensation will be in the best position to avoid costly litigation and may also find themselves at a competitive advantage in the marketplace by ensuring that their compensation practices are well-aligned with their business objectives.



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Footnote

1—Many states have their own wage and hour statutes that have more onerous overtime requirements. For example, in California, employers must pay overtime to non-exempt employees for each day an employee works in excess of eight hours.