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Federal Court Declares That Mortgage Underwriters Are Non-Exempt

Summary

A class of residential mortgage underwriters was adjudged to be entitled to overtime compensation under the federal Fair Labor Standards Act (“FLSA”).¹ In a federal Ninth Circuit Court of Appeals decision² rendered in July, a California-based bank was found to be liable for misclassifying its mortgage underwriters as exempt under the FLSA’s “administrative” category, which is described in the Department of Labor’s regulations at 29 CFR 541.200(a) *et seq.* (Whether any specific employee or class of employees is exempt under the FLSA depends on individual facts and circumstances, so this decision should not be viewed as definitive for all individuals who work as mortgage underwriters).

The FLSA requires covered employers³ to comply with federal minimum wage and overtime rules, and it also established exemptions from those rules for certain types of employees. The state of California—and increasingly local agencies—overlay their own minimum wage and overtime rules. This decision only addresses requirements under the FLSA.

¹ 29 U.S.C. § 201 *et seq.*

² *McKeen-Chaplin v. Provident Savings Bank*.

³ The FLSA applies to employers whose annual sales total \$500,000 or more or who are engaged in interstate commerce.

The FLSA created exemptions from the minimum wage and overtime rules for, among others, individuals employed as bona fide executive, administrative, and professional employees. Among these, the administrative exemption is the least clearly defined and is the subject of substantial litigation, including this case.

The Bank’s Mortgage Underwriters

The plaintiff class includes underwriters and senior underwriters who have authority to approve loans in amounts up to \$500,000 and \$650,000 respectively. As described in the decision, loan transactions at the defendant bank begin with a loan officer or broker who works with a borrower to select a loan product. A loan processor then runs a credit check, gathers further documentation, and assembles the file.

From there, the file goes to a mortgage underwriter, whose primary responsibility is to determine whether the borrower’s credit profile meets the bank’s standards so that the bank may accept the loan request. The underwriters’ duties include reviewing applications using guidelines established by the bank and secondary market investors who purchase the loans (primarily Fannie Mae, Freddie Mac, and the Fair Housing Administration). In doing so the underwriter analyzes complex customer loan applications, and has the discretion to

impose conditions that must be met before a loan is approved. An underwriter may suggest a counteroffer (communicated through a loan officer) of a different loan product for which the applicant is qualified. An underwriter may also request that the bank make exceptions in approving a loan that does not satisfy guidelines.

On these facts the District (trial) Court ruled that the underwriters qualified for the administrative exemption because they perform "quality control" or similar activities directly related to the bank's general business operations. But on appeal, the Ninth Circuit Court of Appeal reversed.

The Administrative Exemption

The administrative exemption is defined and refined in a series of DOL regulations and interpretations. In relevant part, whether a person is an exempt administrative employee is determined by a three-prong test: (a) whether the employee's salary meets a minimum threshold; (b) whether the employee's primary duty is 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 (c) whether the employee's "primary duty includes the exercise of discretion and independent judgment with respect to matters of significance."⁴

The Court addressed only (b) as the salary test was not an issue and the exemption applies only if all three conditions are satisfied. Having found in this case that the conditions described in (b) are not met, the

Court did not address the conditions listed in (c).

Section 541.201(a) of the regulation states that work that is directly related to the management or general business operations consists of "assisting with the running or servicing of the business, as distinguished, for example, from working on a manufacturing production line or selling a product in a retail or service establishment."

The application of this so-called "administrative-production dichotomy" has led some courts to limit availability of the administrative exemption to high level employees at the department or enterprise level. Thus even a highly compensated office worker in a complex field who works with little supervision might be deemed non-exempt because his or her work can be analogized as part of a production line of a manufacturing firm.

Still another part of the DOL's regulation at Section 541.203(b) provides an example of exempt financial services industry employees. These are employees whose duties:

"include work such as collecting and analyzing information regarding the customer's income, assets, investments or debts; determining which financial products best meet the customer's needs and financial circumstances; advising the customer regarding the advantages and disadvantages of different financial products; and marketing, servicing or promoting the employer's financial products."

⁴ 29 CFR Section 541.200.

Importantly, the exemption is not available to those employees “whose primary duty is selling financial products.”

The Decision

The 9th Circuit Court found that the underwriters’ primary duties relate to the production of mortgage loans rather than consisting of assisting in the running and servicing of the bank’s business. It noted that the underwriters do not decide what the bank’s policies or standards ought to be, but rather assess whether applications for loans fell within those policies or standards set by the bank. In the Court’s view, the underwriters did not perform functions that related to the bank’s overall operations. This suggests that if the underwriters’ duties did include helping to establish the bank’s credit policy, the Court would rule differently.

The Court rejected the bank’s argument that the underwriters’ work was exempt under the DOL’s regulation on financial services industry employees (Section 541.203(b)). It reasoned that while some of the underwriters’ duties coincided with those listed in the regulation, the crux of the work involves “producing a reliable loan.” Noting that the DOL has determined that mortgage loan officers do not qualify as administrative employees because their primary duty is to make sales, the Court found that mortgage underwriters’ duties “are most accurately considered employees responsible for production, not administrators who manage, guide, and administer the business.” Reversing the District Court’s ruling, the 9th Circuit Court held that “the question is not whether an employee is essential to the business, but rather whether her primary duty goes to the heart of internal

administration—rather than marketplace offerings.”

Basis For US Supreme Court Review

The two other U.S. Circuit Courts that have addressed this question arrived at opposite conclusions. The 2nd Circuit in *Davis v. J.P. Morgan Chase & Co.*⁵ also found that the work of mortgage underwriters is not exempt administrative work as it falls under the category of production. In contrast, the 6th Circuit⁶ held that mortgage underwriters are exempt as they “perform work that services the Bank’s business, something ancillary to [the Bank’s] principal production activity.” By siding with the 2nd Circuit, the 9th Circuit Court deepened the judicial split and thus gives the U.S. Supreme Court grounds to review the decision.

CBA is working with the American Bankers Association and other groups to file an amicus brief in support of the bank petition, expected to be filed next month.

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⁵ 587 F.3d 529 (2d Cir. 2009)

⁶ *Lutz v. Huntington Bancshares, Inc.*, 815 F.3d 988, 995 (6th Cir. 2016).