

## STOCKBROKERS MAY BE ELIGIBLE FOR OVERTIME PAY

### DID YOU KNOW THAT STOCKBROKERS MAY NOT QUALIFY AS EXEMPT EMPLOYEES UNDER THE FAIR LABOR STANDARDS ACT?

In recent class actions, groups of stockbrokers<sup>1</sup> have challenged their classification as exempt employees under the Fair Labor Standards Act (FLSA or Act) and demanded payments at the 150% (time-and-a-half) overtime premium for past hours worked in excess of 40 hours in a week during the preceding years. This type of FLSA litigation is on the rise and can potentially result in substantial awards against employers or force employers to enter into costly settlements. Employers in the financial sector should be forewarned and take steps to ensure that they have properly classified their employees.

### UNDERSTANDING THE RISK—COLLECTIVE ACTIONS BASED ON IMPROPER EXEMPTIONS

The last few years have seen a deluge of litigation under the FLSA. The recession has only fueled this trend, which is expected to continue at an increasing rate.

Under the Act, employees who believe they are owed overtime pay can sue individually or in what is known as “collective actions” (akin to class actions). 29 U.S.C. § 216(b). Moreover, employees may also bring individual or class action claims under state overtime wage laws, which are not preempted by the FLSA. In addition to recovery of overtime wages for all hours worked above 40 hours in a week for the preceding two years of employment (three if the Act was violated willfully), employees may also recover attorneys’ fees and liquidated damages in the amount of unpaid overtime. Together, these can total huge sums potentially payable by employers.

The trend for broker employees to file overtime claims and to achieve success on these claims is a relatively recent phenomenon. In 2006, for example:

- A large money center bank settled a claim with its financial adviser employees for US\$98 million.
- A securities firm also settled a claim with a collective action class of 1,800 current and former discount broker employees.
- A large money center bank paid a US\$14 million settlement to compensate loan

<sup>1</sup> Similar positions with different job titles than “stockbroker” have also been affected, including account executives, financial executives, financial consultants, financial advisors, and investment professionals

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account executives who claimed they were wrongfully treated as exempt from overtime requirements.

- A large foreign bank paid US\$87 million in a settlement of its advisers' FLSA claims.
- In a California federal court action, an investment bank agreed to pay US\$42.5 million.
- An investment bank settled broker claims for US\$37 million.

These payments, in massive lump sums, might have been avoidable with more careful FLSA evaluation.

Despite increasing attention on broker exemption issues, employees have continued to claim exemption errors by their employers and to succeed in pursuing or settling their claims. Courts have certified collective actions and class actions in many states, including California, New York, New Jersey, Pennsylvania, Ohio, Minnesota, and Texas. Settlements continue as well; in May 2009, for instance, a preliminary settlement of an overtime claim under the Act against a money center bank by a class of its financial advisers provides for a US\$39 million payout for the employees, pending final court approval.

## SCANNING THE TRADING FLOOR—WHO IS EXEMPT?

The Act compels employers to pay their employees time-and-a-half for each hour that they work over 40 hours in a workweek. 29 U.S.C. §207(a). Only those employees who meet criteria to be “exempt” under the Act are not entitled to this overtime premium. The employer bears the burden of classifying an employee as “exempt” by demonstrating that a given employee or group of employees is employed in a “bona fide” executive, administrative, or professional capacity. 29 U.S.C. §213. Additionally, to earn an exemption, all such executive, administrative, or professional employees must be compensated on a salary basis at a rate of not less than US\$455 per week. 29 C.F.R. §§ 541.100 - 300.

Many employers have long assumed that well-compensated financial sector employees are exempt under the

exemption for administrative employees. Under 20 C.F.R. §541.200(a), “[t]he term ‘employee employed in a bona fide administrative capacity’” means “any employee” who is:

1. compensated on a salary or fee basis at a rate of not less than US\$455 per week;
2. whose *primary* duty is the performance of office or non-manual work directly related to the management or business operations of the employer or the employer’s customers; and
3. whose primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.

For at least 15 years, since the US Department of Labor issued an opinion letter stating that financial sector employees could qualify as exempt under FLSA, employers have relied upon this exemption for financial services employees, often without reconsideration. Dept. of Labor, FLSA, 1994 WL 1004755 (March 7, 1994). This exemption has stretched to include nearly all employees dealing with investors, particularly those known by a variety of titles including stockbrokers, account executives, financial executives, financial consultants, financial advisers, and investment professionals.

However, changing industry and market conditions may have altered the compensation structures and job responsibilities of financial sector employees in such a way that these employees may no longer qualify for exemption from overtime requirements. Employers have been caught off-guard, and sanctioned heavily for the error, by not adapting their exemption preconceptions in light of these changes.

## WHEN CONDITIONS BECOME BEARISH— PITFALLS FOR FINANCIAL SECTOR EMPLOYERS *Duties Requirements*

Brokers and other financial industry employees have historically met the duties requirements for FLSA’s administrative exemption by accomplishing tasks including “collecting and analyzing information regarding the customer’s income, assets, investments or debts;

determining which financial products best meet the customer's needs or financial circumstances; advising the customer regarding the advantages and disadvantages of different financial products; and marketing, servicing, or promoting the employer's financial products." 29 C.F.R. §541.203. However, according to the Department of Labor, employees whose *primary* duties include selling financial products will *not* qualify for the exemption. Dept. of Labor, FLSA 2006-43 (November 27, 2006).

Employers could face difficulties in maintaining exempt status for their broker employees if their primary job responsibilities do not reflect tasks beyond selling. Employees who engage in cold-calling or order taking for clients as their primary duty, rather than analyzing customer needs and providing advice regarding sales, may well fail to qualify for exemption. Additionally, the United States Supreme Court has ruled specifically that finance employees and financial institutions cannot qualify for the FLSA exemption relating to retail sales of goods and services. *Mitchell v. Kentucky Finance Co.*, 359 U.S. 290 (1959).

To satisfy the administrative exemption, brokers should use their "knowledge of the securities industry and markets to analyze and interpret the clients' investment objective in light of various factors, and then provide individualized investment advice that is suited to those objectives." Dept. of Labor, FLSA 2006-43 (November 27, 2006). Job titles alone are insufficient to prove that a broker's responsibilities satisfy these analytical requirements. Indeed, the Department of Labor acknowledged explicitly the interchangeability and malleability of job titles in the financial sector and emphasized the importance of focusing on employees' job descriptions and actual responsibilities when evaluating their exemption status. *Id.*

### **Salary Requirements**

In boom times, few employers consider the minimum salary requirement of the FLSA to be a barrier to exemption for their broker employees. However, the minimum salary requirement is becoming increasingly relevant as broker compensation dips. The minimum salary of US\$455 per

week must be guaranteed for *every workweek* that a broker works, regardless of the quality of the work or amount of time actually spent working. This payment must come at regular pay periods, *irrespective of the brokers' earnings in the period*. Especially given the falling markets, attention should be paid to the impact of slipping commissions and lower earned fees on the exempt-status of broker employees.

Employers cannot count commissions or bonuses toward the minimum salary requirements and therefore have to be careful about becoming complacent about the gross amounts brokers are being paid. Commissions and account fees may be paid above the guaranteed salary or employers may credit the salary against subsequent commission or fee payments; these payments cannot be counted prior to earnings as incorporated in the salary calculations for FLSA purposes. Dept. of Labor, FLSA 2006-43 (November 27, 2006). Thus, the US\$455 weekly salary must stand alone as a guaranteed payment.

Employers have found false solace in the FLSA exemption for employees earning a yearly salary above US\$100,000. This exemption for "highly compensated employees" requires that the employee perform office work that regularly and customarily includes performance of duties akin to an administrative, professional, or executive employee. 20 C.F.R. §541.601. The annual compensation must include, at a minimum, the US\$455 weekly guaranteed salary. *Id.* This permits employers to exempt employees from overtime requirements even if their job functions include sales in large part. However, this allowance for sales activities does not alter the salary requirements for the exemption; the US\$100,000 annual compensation must be guaranteed even if the discretionary add-ons from sales are not earned. The fickle nature of the broker business, particularly in the recession, may make this guarantee too risky for employers and undermine the exemption.

### **RE-EVALUATING EXEMPTIONS AND ENSURING COMPLIANCE**

The Department of Labor has estimated up to 70% of all employers do not comply with the FLSA. Employers looking

to avoid the costs associated with litigation and overdue overtime payments would be well-served by re-evaluating their treatment of exemptions for brokers and other similar financial service employees.

*We hope that you have found this advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:*

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