



## **What HR Professionals Need to Know About the Labor Department’s Revisions to the White-Collar Overtime Regulations**

By Michael J. Eastman

On May 23, the Department of Labor (DOL) published significant revisions to its regulations implementing the Fair Labor Standards Act’s (FLSA’s) exemption for executive, administrative and professional (EAP) employees, often referred to as the “white-collar” exemption.<sup>1</sup> This paper outlines what changed in the regulations, what didn’t change and what HR professionals need to consider as the regulations are implemented.

### **What Changes Have Been Made to the Regulations?**

- **Increased Minimum Salary Level.** FLSA regulations generally prohibit employers from classifying an employee as exempt from overtime under the EAP exemption unless the type of work that the employee performs meets one of the EAP job duties tests, the employer pays the employee on a salary basis, and the employee earns a minimum salary (in 2004, the DOL set the minimum salary at \$455 per week or \$23,660 per year). Under the DOL’s final rule, the minimum salary level increases to \$913 per week or \$47,476 per year. The new salary level is set at the 40th percentile of weekly earnings of full-time salaried workers in the lowest-wage census region, currently the South.
- **Increased Guaranteed Salary Level for Highly Compensated Employees.** The EAP regulations include a more-simplified duties test that employers may use to classify highly compensated employees (HCEs). In order to use the simplified duties test, employees must be guaranteed an annual salary. In 2004, the DOL required a guaranteed salary of at least \$100,000. The revised rules raise the guaranteed annual salary to \$134,004, beginning on December 1, 2016. This level represents the 90th percentile of full-time salaried workers nationally. Of course, employers are still free to use the standard duties test to evaluate employee classifications, even for highly paid employees, and need not utilize the simplified duties test.
- **Automatic Adjustments to Salary Level.** The DOL has put into place a new mechanism that will automatically update both the minimum salary level and the guaranteed annual salary for HCEs every three years beginning on January 1, 2020. The DOL plans to update both salary levels using the same measures by which they have been set this year:

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<sup>1</sup> For a copy of the final rule and additional materials from the Department of Labor, see: <https://www.dol.gov/whd/overtime/final2016/>.

the 40th percentile of weekly earnings of full-time salaried workers in the lowest-wage census region for the minimum salary level and the 90th percentile of full-time salaried workers nationally for the guaranteed salary level for HCEs. The DOL will publish the updated salary levels 150 days in advance of the effective date.

- **Ability to Attribute a Small Portion of Bonus or Commission Payments to the Minimum Salary Level.** For the first time, the DOL will now permit employers to attribute a small portion of nondiscretionary bonuses, incentive pay and commissions toward the minimum salary level. As set forth in the new regulations, as long as an employee earns 90 percent of the minimum salary as salaried base pay (\$821.70 per week), the additional portion of the minimum salary level (up to 10 percent, or \$91.30) may be made up through nondiscretionary bonuses, incentive pay and commissions. Importantly, to be counted toward the minimum salary level, these additional payments must be made at least quarterly. If the bonus payments, incentive pay or commissions are not sufficient to close the gap with the minimum salary level over the course of the quarter, then the employer may make a catch-up payment during the pay period immediately following the quarter in question. If an employee falls below the minimum salary level for the quarter, then the employee must be reclassified for the period as nonexempt and paid any overtime due for the quarter.
- **Effective Date.** The new regulations are scheduled to go into effect on December 1, 2016. Importantly, employers should ensure that they are in compliance by the pay period that includes December 1, which could be several days before.

### What Has Not Changed

- **Duties Test.** The DOL has not made any changes to the duties tests for the executive, administrative or professional exemption. The DOL has also not changed the requirement that EAP employees be paid on a salary basis, as opposed to hourly.
- **Timekeeping Requirements.** No changes have been made to the regulations governing how employees are to record or report hours worked. However, if employees are reclassified as nonexempt, they may have to comply with timekeeping rules that have not previously applied to them.
- **Regulations Regarding Part-Time Employees.** The DOL has not modified its regulations to accommodate workers who perform exempt duties on a part-time basis. Even if an employee only works two days a week, he or she must earn the full minimum salary level of \$913 per week in order to be considered exempt.
- **Jobs Excluded from the Salary Level Test.** There is still no salary level requirement for outside sales employees, teachers, and practicing doctors and lawyers.
- **Other FLSA Overtime Exemptions.** The only overtime rules that have been changed are those that interpret the law's exemption for executive, administrative and professional

employees, as well as certain computer workers.<sup>2</sup> No changes have been made to other FLSA exemptions, such as the overtime exemption for certain retail employees paid commissions or the minimum wage and overtime exemption for various agricultural employees, employees covered under the Motor Carrier Act, and seasonal employees of amusement or recreational establishments, among others.

- **State Law Considerations.** State laws may still provide greater protections than the FLSA, and state law exemptions may be more restrictive than the EAP exemption. However, employers in states that have traditionally had more protective laws, such as California, will now have to evaluate coverage under the FLSA in light of the increases to the salary threshold.

### **What HR Professionals Should Do Now**

Now that the DOL has finalized its rule, employers should assess their workforce to determine the extent to which any changes will need to be made in order to remain compliant after the December 1, 2016, effective date.

**Identify Employees Who May Be Impacted.** The most immediate focus will naturally be on identifying employees currently classified as exempt who earn less than the new minimum salary level of \$913 per week. This should include all currently exempt EAP employees with salaries lower than \$913, even if they work part time and their full-time equivalent salary would be above the threshold because the DOL's regulations only consider actual salary paid for purposes of the exemption.

However, these are not the only employees who will be impacted by the revisions to the regulations. Employers may also want to assess the impact on employees who have the same or similar job duties but are paid above the new minimum salary threshold. Raising salaries for some employees also could create salary compression issues concerning other employees who are more senior, and employers may wish to provide additional salary adjustments to those employees. Salary compression issues may be compounded when considering the impact of regular increases to the minimum salary level in the years ahead.

**Assess Whether Changes Are Needed and What Types of Modifications Are Possible.** After identifying the affected workers, employers will need to estimate the extent to which they work more than 40 hours in a week and how many hours they typically work. For many employers, this calculation will be difficult because it may be hard to determine how many hours employees are working offsite. Employers with employees affected by the changes have several options available:

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<sup>2</sup> Computer workers who meet the duties test set forth in the regulations may be exempt if paid at least \$913 per week on a salary basis. Alternatively, computer workers may be exempt if paid at least \$27.63 per hour.

- **Reclassifying Employees.** Employees performing exempt duties who earn below \$913 per week must be reclassified as nonexempt if their salaries are not raised above the threshold. While nonexempt workers may be paid on an hourly or salaried basis, overtime requirements apply, and thus employers will want to be sure that they can accurately track hours worked and ensure that employees are not engaging in any off-the-clock work. If the impacted employees work hours that vary regularly from week to week, it may be worth considering less-traditional forms of overtime payment, such as the “fluctuating workweek method.” However, for most employers, the traditional method of paying time-and-one-half premium pay for hours worked in excess of 40 will likely be the simplest.
- **Raising Pay to Retain the Exemption.** Alternatively, employers could choose to increase employee pay to the minimum salary level. While this may be an attractive option for employees who are now earning salaries close to the minimum, it may be too costly or may simply not make sense given a particular workforce and business model. Employers may also wish to consider whether they could take advantage of the DOL’s new rule allowing small amounts of commission or nondiscretionary bonuses to be attributable to the minimum salary level. While this may provide helpful flexibility for some employers, the risk of after-the-fact reclassification if incentive pay falls short should also be thoroughly considered.
- **Restructuring.** In some cases, the best option will be restructuring the workforce or particular jobs. For example, it may make sense to remove some responsibilities from a group of employees so that they can complete their jobs in 40 hours per week while being classified as nonexempt. At the same time, those responsibilities might be transferred to another group of employees who have had their salaries increased to remain exempt. Another type of restructuring may be necessary if an employer finds that it has employees in a single job group who could be classified as exempt while others could not. The FLSA does not require that all employees in a single job group be classified in the same way. However, employers should consider whether classifying all employees as nonexempt would make more sense from a management perspective, considering potential employee concerns about equity and fairness.

**Consider All the Costs.** While the costs of additional overtime or increasing pay to meet the new salary level are the most obvious financial burdens that will be imposed by the new rule, don’t forget about less apparent costs or savings. For example, what will be the impact on benefits? Some benefits may increase along with increases to salary, while others, such as the amount of paid time off available, may be based on exempt status and could potentially decrease. Will reclassified employees have access to the same training programs and other professional development opportunities? Will you need to implement new training for reclassified workers who may now need to significantly change how they work (and when they don’t), or for those who will be responsible for supervising these workers and who may have less experience managing nonexempt employees?

Finally, it is important to remember that the changes you make will not only impact current employees but future employees as well. How will the changes you make impact your plans for recruiting top talent and what adjustments can be made to mitigate any negative impact?

**Develop a Communication Plan.** Employees are necessarily concerned when workplace changes impact the way they work or how they are paid. Employees who have been reclassified may feel like they have been demoted or are less valued or less trusted as a nonexempt employee. They may also be concerned that they will have less opportunity for advancement. HR professionals should develop a comprehensive communication plan for employees that includes helping supervisors understand changes needed to supervise newly-nonexempt employees and how to communicate expectations. This will help increase employee understanding of the changes that must be made, help allay employee fears, ensure employees feel valued and help ensure a smooth transition. Employers may also plan to follow up with employees after changes are made to ensure compliance and help detect any issues that should be addressed.

### **Review Policies and Practices**

- **Overtime Work.** Employers should review their policies and practices related to exempt status, as well as to working overtime and working off-the-clock. Keep in mind that the new rules may require behavior change by employees who are reclassified as nonexempt, such as limiting (or prohibiting) after-hours use of e-mail and performing of other work. Similarly, employers may find it helpful to assess their own culture and expectations regarding work performed outside of traditional working hours. Now is the time to ensure that these policies are revised and to clearly set forth expectations, and to explain these policies and expectations to employees.
- **Current Classifications.** Employers may also wish to take this opportunity to conduct a self-analysis of employee classification to ensure that all employees are properly classified. Making any needed adjustments may be easier to do now while making the changes imposed by the new regulations, rather than doing so at a separate time in the future. Employers considering this approach should consult counsel to ensure that the reclassification project is appropriately designed to minimize potential risk and maximize potential benefits.

**Ensure Changes Are Made in Time.** The final rule is effective on December 1, 2016. Employers should ensure that any required changes will be effective before the start of the pay period that includes December 1. Employers should remember that the FLSA is enforced by the Department of Labor, which may conduct compliance investigations with or without a formal complaint, and for private litigation purposes as well. Improper classification and off-the-clock work are matters that are frequently litigated.

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## **Additional SHRM Overtime Resources for HR professionals**

**[SHRM 2016 FLSA-related conference sessions](#)** – at **SHRM's 2016 Annual**

**Conference & Exposition.** New programming includes sessions providing an in-depth analysis of the overtime rule and practical advice to nonprofit employers that are particularly impacted by the new salary threshold and automatic salary updates.

**[SHRM's FLSA Overtime Rule Resources](#)** – web page with everything you need to know about the FLSA overtime rule changes.

**[Webinar: Understanding DOL's New Overtime Rule](#)** – originally aired on May 19, 2016.

**[Webinar: California and the Federal FLSA Overtime Rule](#)** – originally aired on May 27, 2016.