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What are the Most Significant Changes the DOL Made to the FLSA's White Collar Overtime Regulations?

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The U.S. Department of Labor (DOL) published the final rule revising the “white collar” overtime exemption regulations on May 18, 2016. This publication was the result of a process that began in March 2014 when President Obama directed the Secretary of Labor to review and “modernize” the current overtime regulations. In the final rule, the DOL estimates that the changes will impact 4.2 million white collar workers.

The most significant change made by the final rule is raising the minimum salary level for the white collar—executive, administrative and professional—exemptions under the Fair Labor Standards Act (FLSA). The final rule raises the minimum salary level from \$455 per week, or \$23,660 per year to \$913 per week, or \$47,476 per year. An individual earning below that threshold will not fall under the white collar exemptions from overtime pay. The final rule permits additional compensation – such as bonuses and commissions – to satisfy up to 10% of the minimum salary level. The final rule also raises the salary requirements for highly compensated employees from \$100,000 per year to \$134,004 per year. For the first time, the DOL has included a mechanism to automatically increase both of these salary levels. The new regulations go into effect on December 1, 2016.

Key Changes

The final rule spans over 160 pages. The following describes the main changes the final rule makes to current law:

Minimum salary level: Since 2004, the salary level for white collar overtime exemptions has been \$455 per week, or \$23,660 per year. The new rule more than doubles this amount, setting the minimum salary at \$913 per week, or \$47,476 per year. This rate was established based on the 40th percentile of earnings of full-time salaried workers in the lowest-wage census region in the United States, currently the South. This increase now

places the federal minimum salary level higher than the corresponding salary levels in California (currently \$41,600 per year) and New York (currently \$35,100 per year).

Use of nondiscretionary bonuses and commissions: The DOL's final rule permits employers to use certain other forms of compensation to satisfy up to 10% of the new minimum salary requirements. The additional compensation must be paid at least quarterly and may include nondiscretionary bonuses, incentive payments and commissions. The final rule requires employers to pay exempt employees at least 90% of the minimum salary level per workweek. This equates to \$821.70 per workweek or \$42,728.40 annualized. Additional compensation – up to \$4,747.60 per year, or \$1,186.90 per quarter – may be used to satisfy the remainder of the salary requirements. If, at the end of a quarter, the salary plus 10% of the additional compensation does not equal \$913 per workweek, the final rule permits a one-time shortfall payment to be made. The shortfall payment must be paid no later than the first pay period following the end of the quarter. The shortfall payment *must* satisfy the minimum salary for the preceding quarter, as spread over a 13-week period. Such a payment applies only to the preceding quarter and cannot be used to meet the salary requirements for the quarter in which it was paid. If a shortfall payment is not made, overtime is then owed for hours worked over 40 per workweek in the corresponding quarter.

Highly compensated employees: The current minimum salary level to qualify as a highly compensated employee is \$100,000 per year. The final rule increases it to \$134,004 per year. According to the DOL, this amount represents the 90th percentile of full-time salaried workers nationally, as determined by the Bureau of Labor Statistics (BLS). To satisfy the requirements of the highly compensated employee test, employees must be paid a minimum of \$913 per week in guaranteed salary. The shortfall mechanism described above *cannot* be applied to employers who rely on the highly compensated employee test. However, for compensation paid in excess of the minimum \$913 per week, the regulations remain unchanged that bonuses or other incentive payments can be used to establish the \$134,004 per year required salary. In other words, additional compensation of up to \$86,528 – in the form of bonuses, commissions, or incentive payments – can be used to satisfy the highly compensated employee test.

Automatic increases: The final rule automatically increases the minimum salary level every three years. The first update will take effect January 1, 2020, with future increases set to take effect on January 1 every three years. The minimum salary for exempt white collar workers will be pegged to the 40th percentile of weekly earnings of full-time salaried workers in the lowest wage census region in the United States, currently the South. During the rulemaking's comment period, many raised concern that tying increases to the 40th percentile of full-time salaried workers would result in dramatic increases to the minimum salary. Addressing this concern, the DOL indicated that only a "small fraction" of newly overtime-eligible employees will be converted to hourly workers; therefore, the impact of the new regulations will have a "negligible" impact on the 40th percentile data used to calculate automatic increases. The highly compensated employee salary threshold will be reset every three years at the 90th percentile of earnings of full-time salaried workers nationwide, based on BLS data from the prior year's second quarter. The DOL will publish the new rates in the *Federal Register* at least 150 days before the updated salary levels go into effect.

Effective date: The new changes will go into effect on December 1, 2016. As of that date, the minimum salary levels for white collar exemptions and highly compensated employees must be in place. The final rule contains a non-enforcement policy "for providers of Medicaid-funded services for individuals with intellectual or developmental disabilities in residential homes and facilities with 15 or fewer beds." For the narrow subset of employers who fall under this exception, the DOL will not enforce the updated salary threshold of \$913 per week from December 1, 2016 to March 17, 2019. However, the final rule does not prevent employees from bringing a private action to enforce the new regulations.

What Did Not Change

The main changes presented in the final rule relate to the minimum salary levels that apply to the white collar overtime exemptions, as well as the formulas for calculating and increasing these levels. However, no changes were made to the exemptions for outside salespeople, teachers, lawyers or doctors. Importantly, the final rule does not change the duties tests. As such, the threshold duties required of exempt employees covered by the white collar exemptions must still be met. There are no changes to the definition of the primary duty and the concurrent duties provisions. Additionally, no changes were made to the salary basis test under the FLSA. Therefore, employees must still be paid a fixed, predetermined salary that is not subject to reduction due to variations in the quality or quantity of work in a workweek.

Challenges for Employers

For many employers, the final rule appears as a compromise of sorts; many in the industry feared the rule would be a much broader reworking of the white collar exemptions. After the 2015 release of the proposed changes to the regulations and the DOL's invitation for comments on the duties required for the white collar exemptions, many believed the DOL would take the opportunity to amend the FLSA's qualitative duties standards to more closely resemble California's quantitative standards for the white collar exemptions. Others suggested the DOL might rework or remove the concurrent duty standard for the executive exemption, which would affect employers that rely on supervisors and managers who also perform non-exempt work during a workweek. The result of this compromise is that employers are not required to go through what can be a cumbersome duty analysis for groups of affected employees, although, as noted below, employers should consider taking advantage of this opportunity to review the duties of affected employees.

While the reduction in the salary level from the proposed rule from \$970 per week to \$913 per week in the final rule and the inclusion of a 10% allowance for other compensation to make up the salary level are other compromises the DOL provided, the 10% allowance may be administratively difficult to implement. For example, the DOL left unanswered whether employers relying on this 10% allowance for other compensation must "true up" employees upon termination, or risk the loss of the exemption for the "underpaid" weeks in the corresponding quarter. Moreover, the use of the 10% allowance necessarily requires employers to institute new controls to monitor and ensure that the minimum salary requirements are met each quarter.

Employers also got relief from the annual resetting of the salary level, which is now set to occur every three years. However, for many employers, the ramifications of resetting salaries for some employees, and the wave of related issues, including wage compression against other employees, labor cost and budgeting, and changes to business models, require careful management. Employers should be mindful now of putting in place a process for reviewing salary levels that can be repeated and re-used every three years, so that employers need not "reinvent" the process during each salary reset cycle.

Next Steps

All employers should review the current salary levels and compensation plans for all exempt employees to determine whether the new salary requirements are met. To the extent the decision is made to reclassify employees from overtime exempt to overtime eligible, employers should also develop comprehensive guidance to: (1) determine new hourly rates for impacted employees; (2) revise or update current timekeeping programs and policies to reflect the changes; and (3) implement training for both managers and employees addressing the changes.

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