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Understanding the Final Rule on the Fair Labor Standards Act Overtime Regulations

What is the new rule?

On May 18, 2016, the Department of Labor (DOL) issued new regulations to revise the criteria defining the type of employee who is eligible for overtime pay (non-exempt employee) and those that are not eligible for overtime (exempt employee).

Under the new regulations, the salary threshold was increased to $913/week ($47,476/year), which is almost double what it previously was ($455/week or $23,660/year). However, the duties test still applies. This regulation does not take into account regional or industry pay differences. Additionally, there will be an automatic salary threshold increase every three years to maintain this level at the 40th percentile of full-time salaried workers in the lowest-wage Census region.

The intent of the new rule is to cut down on hours that constitute unpaid overtime, and to ensure that lower wage earners are paid for the extra hours they work.

This change will mean adjusting numerous compensation practices to comply with the new rule and will create several pay-related issues, beyond just reclassifying employees from exempt to non-exempt. Some of the additional challenges the Human Resources team are dealing with include whether to use non-discretionary bonuses to push employees over the exempt-pay threshold, whether employees who are now classified as exempt should be treated as “salaried but non-exempt,” how to confront the risks of salary compression, the impact on benefit programs, the impact on existing telecommuting policies, the impact on timekeeping policies and processes, and how to deal with the strain this will put on compensation budgets.

The effective date of the new rule is December 1, 2016.

Salaried, Non-Exempt

Some job categories and industries merit the use of the salaried, non-exempt approach and some employers will use this approach to manage the human relations aspect of the positions that are now being reclassified as non-exempt. This approach will lessen the employees’ perception that something is being taken away, or the feeling that a certain status associated with being exempt is being diminished.

However, it is important to remember, that employees with the same job title, should be classified the same, irrespective of whether they meet the salary threshold or not. While you can apply the salaried, non-exempt approach on a case-by-case or position-by-position basis, you should not apply it on an employee-by-employee basis. Thus, all employees in the same position, with the same title, should all be classified the same.

Since a good portion of the positions that will be reclassified to non-exempt status, perform exempt-type duties, such as management duties, performance reviews, etc., Human Resources may want to consider shifting some of those duties to other exempt employees in an effort to limit the hours of overtime that someone now being reclassified as non-exempt may incur.

Bonuses and Incentive Pay

For the first time in history, the new rule amends the salary basis test to allow employers to use non-discretionary bonuses and incentive payments (including commissions), to satisfy up to 10% of the new standard salary threshold, provided these payments are made on a quarterly or more-frequent basis. However, commissions or bonuses that put an employee over the threshold must be earned and paid from period-to-period, or the employer could be put at risk. Employers may prefer giving productive employees a quarterly bonus that would help get them closer to the threshold, as an option to increasing base pay.

Under the final rule, if an employee does not earn enough in non-discretionary bonuses and incentive payments in a given quarter to retain the exempt status, the employee would then be entitled to overtime pay for any hours worked throughout the quarter, which can be made in a "catch-up" payment to the employee at the end of the quarter. This should be carefully planned, or an employee could potentially receive non-discretionary bonus/incentive payments AND overtime.

Salary Compression

Salary compression occurs when there is only a small difference in pay between employees performing similar functions, regardless of their skills or experience. Salary compression can also occur when an employee's supervisor is earning close to the same amount as is the employee. In these cases, salary compression would be caused by increasing the salaries of those that are near the threshold to the threshold level in an effort to keep them exempt. Should salary compression occur, any salaries above the threshold amount may also need to be increased in order to maintain internal pay equity within the compensation structure.

While it may seem like a quick, easy fix to just bump up those positions that are near the threshold to meet the threshold, employers should also be aware that this can cause a ripple effect impacting many positions in exempt status that are above the threshold. Addressing this issue could be quite costly to an organization, since many of the positions impacted are higher level positions.

Strained Compensation Budgets

The new FLSA requirements will certainly cause a strain on compensation budgets, with long-term impact. Some of the financial implications include limited funds for pay increases and bonuses, reduction of employer-sponsored benefits, the added cost of overtime for employees who once worked 50-55 hours per week to complete their job duties, and the additional cost of employment taxes on either increased salaries or overtime pay not previously budgeted for.

To the extent possible, employers may consider reducing the hourly rate of exempt employees being reclassified to non-exempt, by using average hours now worked to determine the hourly pay rate. This will help prevent a sudden spike in your overtime budget.

Additionally, start talking with Hiring Managers now to start determining labor budgets for 2016 and beyond, ensuring everyone understands the potential impact.

Impact on Benefits

Important employer-paid benefits could be impacted by the new rule, particularly those only offered to salaried employees or offered as voluntary employee benefits. Such benefits include:

- Number of vacation days and other paid time off accruals
- Group life and group disability benefits
- Long-term disability benefits
- Dental and vision benefits
- Profit sharing, 401(k), Defined Benefit Plan benefits

Due to the requirements of the Affordable Care Act and a strained compensation budget, employers may be forced to offer fewer employer-sponsored benefits, or shift the costs to the employee for these ancillary benefits.

Telecommuting

Typically, telecommuting is reserved for exempt employees, who have broader discretion with their schedules, and the autonomy to control their own time. While the new rule doesn't require that an employer change its telecommuting arrangements, it may require a change in the policy, expectations of the telecommuting employee and monitoring of the employee's work.

Additionally, there could be associated risk for an employer who has employees that will under-report their hours worked and then later present a claim of alleged "off-the-clock" work and then want to be paid for the overtime hours. Clear guidelines on time reporting and approval of overtime for non-exempt employees will help alleviate this concern.

Because employers and employees both potentially benefit from the option to work from home or to work flexible hours, the flexibility with telecommuting is often an important benefit to employees and has been shown to increase job satisfaction, productivity, efficiency and performance while reducing turnover. The many potential benefits from telecommuting can still be maintained under the new DOL rule by establishing clear work-time guidelines and policies for what activities are compensable, what "work" is to be completed, and when employees are expected *not* to work. Additionally, clear communication of the need to record all hours worked and the clear expectation that under-reporting and over-reporting of time is unacceptable is needed.

Timekeeping Policies

In order to ensure full compliance with the new FLSA requirements, organizations will need to update their recordkeeping and timekeeping processes, particularly for those employees that will transition from exempt to non-exempt status; all hours for these employees (including overtime) will need to be tracked. It will be important to establish clear, written policies and procedures for recording time worked and overtime, to include what is considered 'time worked', how overtime is approved and by whom, and the potential disciplinary action for failing to adhere to the policy.

In preparation for the potential impact the new overtime rule may have on your organization, consider the following:

1. Review and identify employees

   Identify and confirm how your current employees are classified, as there will be employees that are not impacted by the changes. Exempt employees that are classified as Executive Exempt, Professional Exempt, Technical Exempt and Administrative Exempt will still need to meet the duties test for their exemption, as well as the salary threshold. Identify which currently classified exempt employees have salaries below or very close to the new threshold.

2. Review and monitor employee hours

   In order to make informed decisions about the treatment of certain positions under the new rule, identify the hours being worked to determine total hours, including overtime. This will help you determine which employees to transition to non-exempt vs which to move up to the salary threshold to maintain the exempt status.

3. Determine which employees will transition to non-exempt status

   After determining the exempt status employees impacted by the rule, a decision must be made on how to proceed. Employers have two options: (1) increase the salary level to maintain exempt status, or (2) transition the employee to non-exempt status. The pay basis for those employees that are transitioning to a non-exempt status will need to be determined (hourly or salaried). Additionally, standard practices are needed to determine whether overtime is necessary and permitted. The rules must be consistent in order to mitigate your organization's exposure to discrimination lawsuits.

4. Determine financial impact

   Employers should analyze the cost of various pay options. Is it less costly to meet the exemption criteria or to reclassify employees below the threshold as non-exempt and pay them overtime? Consider alternative (from salary to hourly) scenarios for converting an employee's job classification status.

5. Review your plan for salary compression

   Ensure that increasing the salaries of employees to meet the threshold does not create salary compression. Also consider the cost of increasing the salaries for corresponding exempt positions to ensure that internal equity in the compensation structure is maintained.

6. Think outside the box

   Consider alternative ways to control labor costs within your organization by load-shifting, adjusting work schedules so that overtime is not incurred, adjusting non-exempt workers' hourly pay so that the weekly compensation (from both regular and overtime hours) adds up to the same amount that they would have made before being reclassified, etc.

7. Create a communication plan

This new rule is expected to have significant implications for an organization. In order to effectively address critical issues associated with the new requirements, develop a communication plan for internally announcing the changes, procedures for reporting hours worked, what work can and cannot be done beyond a regular work week, and the impact to employees. In addition to the new regulations, the communication plan can be used to address employee relations that may result from reclassifications.

8. Provide training

   Provide training to the Human Resources staff, the Payroll Department and Hiring Managers on the new rules. Training should include a brief explanation of the new rules, potential risks of allowing non-exempt employees to work after hours (i.e. check email, respond to phone calls, time spent in mandatory training, time spent on projects from home or while on business travel, etc.), the impact and changes to related policies, and the new timekeeping process.

Whatever decision your organization makes with regard to the treatment and application of this rule, one of the biggest challenges will be maintaining employee morale and helping employees feel valued, regardless of their classification.