

# Morgan Lewis

## LAWFLASH

# DOL UPDATES FLSA OVERTIME EXEMPTION REGULATIONS

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## AUTHORS AND CONTACTS

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The update significantly increases the salary level needed to qualify as exempt under the FLSA's white collar and highly compensated exemptions.

On May 18, the US Department of Labor (DOL) announced the highly anticipated revisions to the rules interpreting the Fair Labor Standards Act's (FLSA's) "white collar" overtime exemptions (Final Rule). The DOL's Final Rule sets forth four key changes to the current exemption test. As discussed in more detail below, the Final Rule

- › increases the minimum salary needed to qualify for the FLSA's white collar exemptions;
- › increases the total annual compensation requirement for highly compensated employees;
- › establishes a mechanism to update these salary and compensation levels automatically every three years; and
- › amends the salary basis test to allow employers to use nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10% of the new minimum salary level.

The Final Rule does not make changes to the duties tests for the white collar exemptions. The changes announced in the Final Rule are effective December 1, 2016.

## BACKGROUND

The FLSA regulations were last updated in 2004. In March 2014, US President Barack Obama directed US Secretary of Labor Thomas E. Perez to "modernize and streamline" the DOL's white collar exemption regulations. On June 30, 2015, the DOL released proposed regulations and a request for comments on a variety of issues. The proposed rule was published in the *Federal Register* on July 6, 2015, and the comment period closed on September 4, 2015. On May 18, 2016, the DOL issued its Final Rule.

## KEY PROVISIONS OF THE FINAL RULE

As noted above, the Final Rule makes four key changes to the current FLSA regulations:

1. Increases the minimum salary level needed to qualify for the white collar exemptions from \$455 per week or \$23,660 annually to \$913 per week or \$47,476 annually (this amount equals the 40th percentile of earnings of full-time salaried workers in the lowest-wage Census Region—currently the

South).

2. Increases the minimum total annual compensation requirement needed to qualify for the highly compensated exemption from \$100,000 to \$134,004 (which is the annual equivalent of the 90th percentile of full-time salaried workers nationally).
3. Establishes a mechanism for updating the minimum salary and compensation levels every three years for these exemptions going forward. The minimum salary level will be updated to maintain a threshold equal to the 40th percentile of weekly earnings of full-time salaried workers in the lowest-wage Census Region. Additionally, the Final Rule includes a mechanism for automatically updating the highly compensated employee compensation level to maintain the threshold equal to the 90th percentile of annual earnings of full-time salaried workers nationally. The DOL will publish all future updated rates in the *Federal Register* at least 150 days before their effective date.
4. Amends the salary basis test to allow employers to use incentive payments (including commissions) and nondiscretionary bonuses to satisfy up to 10% of the new minimum salary level. The DOL stated that for employers to credit nondiscretionary bonuses and incentive payments toward a portion of the minimum required salary level, the payments must be made on a quarterly or more frequent basis. The Final Rule also permits an employer to make a “catch-up” payment in the event that an employee does not receive enough in nondiscretionary bonuses and incentive payments to remain exempt.

As stated above, the Final Rule makes no changes to the duties tests.

## **EFFECTIVE DATE**

The effective date of the changes in the Final Rule is December 1, 2016. Future automatic updates to threshold amounts will occur every three years beginning on January 1, 2020.

## **RECOMMENDED NEXT STEPS**

The significant increase in the salary basis level for the white collar exemptions will require employers to quickly identify and evaluate positions compensated below the new threshold and decide whether to reclassify employees or raise their salaries. In making this determination, employers should look at the hours worked for those employees under the salary threshold to estimate the potential cost of paying overtime.

For those employees who will be reclassified, employers should prepare talking points for managers and employees about the change, the reason for the change, and how the change will impact their compensation, benefits, and opportunities for advancement. Additionally, employers should develop training and robust time reporting policies for reclassified workers who will not be accustomed to recording hours worked.

To the extent that reclassified employees previously were receiving bonuses, commissions, or other incentive compensation, employers will need to rethink those forms of compensation or carefully evaluate how to factor them into the regular rate of now-hourly workers. Employers should also be prepared to follow up and audit timekeeping practices for newly reclassified employees to ensure that they are following proper processes and procedures. In addition, it is important for employers to remember to comply with state wage and hour laws for the newly reclassified employees.

## **CONTACTS AND UPCOMING WEBINAR**

On May 26, 2016, at 2:00 pm Eastern, Morgan Lewis will be hosting a one-hour webinar to discuss the new regulations and to address what employers should do in light of the changes, including consideration of compensation plan options and communications strategy in the event of a reclassification. Register for the webinar.

Additionally, if you have any questions or would like more information on the issues discussed in this LawFlash, please contact any of the following Morgan Lewis lawyers:

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