New Overtime Rules

What You Need to Know

A more human resource.

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How to Comply with the New Overtime Rules

Background:

The FLSA requires covered employers to pay "non-exempt" employees at least the minimum wage for each hour worked as well as overtime pay for all hours worked in excess of 40 in a workweek. Some states have additional overtime requirements. Check your state law for more information.

"Exempt" Employees:

While most employees are "non-exempt," the FLSA provides for exemptions from its minimum wage and overtime requirements for certain administrative, professional, executive, outside sales, and computer professional employees. These employees are known as "exempt" employees. To be considered "exempt," employees must generally satisfy all of these three tests:

Salary-level test

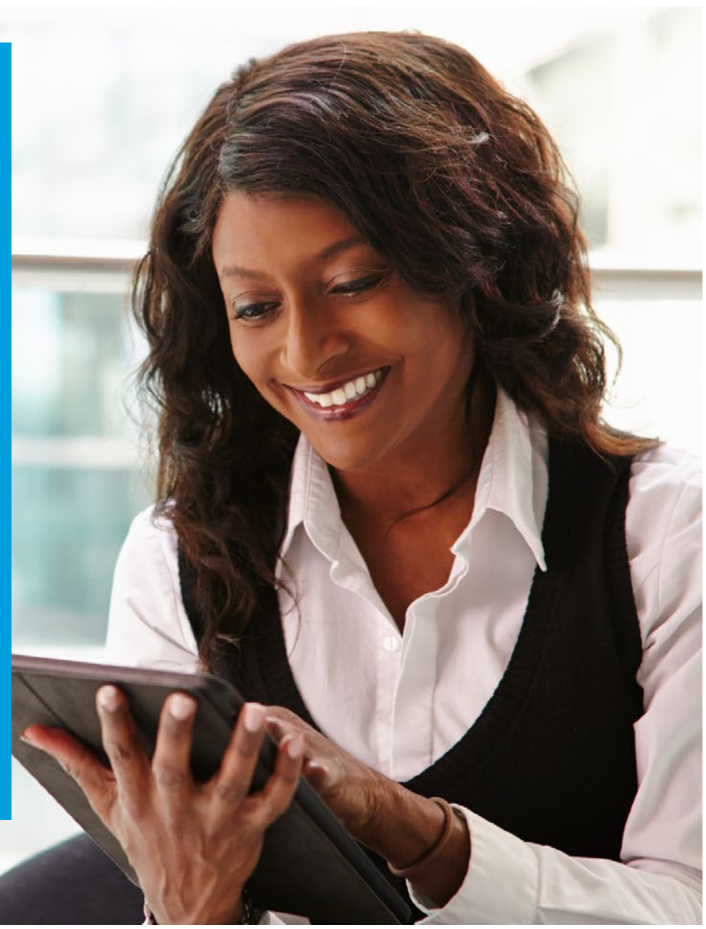
The employee must earn a weekly salary that meets current minimum requirements.

Salary-basis test

With very limited exceptions, the employee must receive their full salary in any week they perform work, regardless of the quality or quantity of the work.

Duties test

The employee's primary job duties must meet certain criteria.



There is also an exemption for "highly compensated" employees who customarily and regularly perform at least one of the exempt duties or responsibilities of an executive, administrative, or professional employee. Until December 1, 2016, these employees must receive total annual compensation of at least $100,000 to qualify for this exemption.

How to Comply with the New Overtime Rules

The Department of Labor (DOL) has issued final rules that will substantially increase the minimum salary requirement to be exempt from overtime under the Fair Labor Standards Act (FLSA). The final rules are effective December 1, 2016.

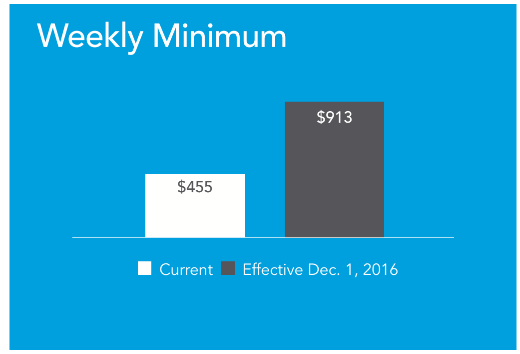
What Is Changing?

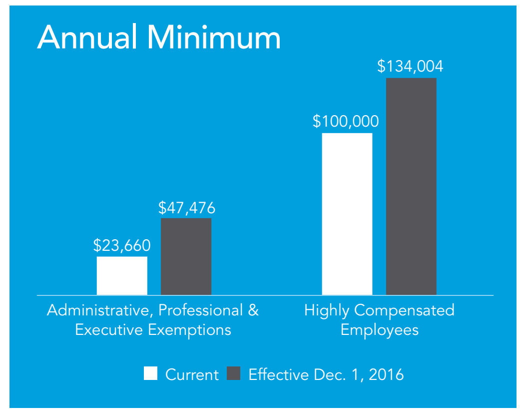
Here is a summary of the final rules:

- **Salary increase for certain exemptions.** The minimum salary requirement for the administrative, professional (including the salaried computer professional), and executive exemptions increases from $455 per week to $913 per week ($47,476 annually).
- **A portion of certain bonuses count.** For the first time, employers may use nondiscretionary bonuses, incentive payments, and commissions, to satisfy up to 10 percent of the aforementioned minimum salary requirement, as long as these forms of compensation are paid at least quarterly.
- **Increase for highly compensated employees.** The minimum total compensation required for the highly compensated employee exemption will increase to $134,004 per year, which must include at least $913 per week paid on a salary basis.
- **Automatic updates.** There will be automatic adjustments to these minimum salary requirements every three years.

Note: The DOL made no changes to the duties tests for the administrative, professional, executive, highly compensated, computer professional, or outside sales exemptions.

Read the DOL's guidance on the new rules.





Effective Dec. 1, 2016, the **minimum salary requirement** for certain exemptions increases from $455 per week to **$913 per week.**

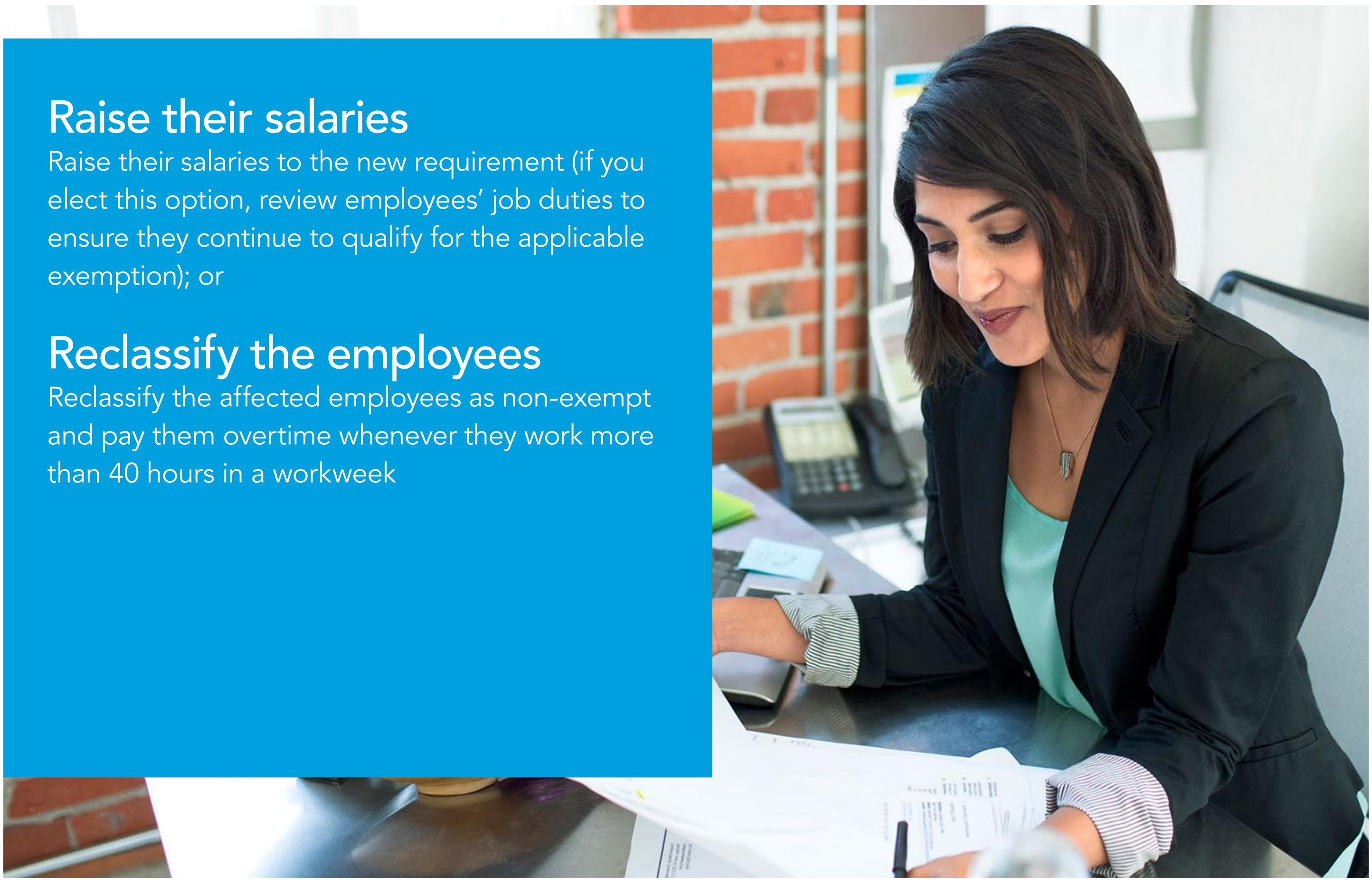
How to Comply with the New Overtime Rules

Potential Impact on Exempt Employees:

If your exempt employees earn less than the new salary requirement, they will no longer meet exemption criteria and must be classified as non-exempt and paid overtime whenever they work more than 40 hours in a workweek. An employee who meets all applicable exemption criteria, including the new minimum salary requirement, salary-basis test, and applicable duties test, may continue to be classified as exempt.

Options for Compliance:

If your exempt employees' salaries fall below the new minimum, you will generally either have to:



Raise their salaries

Raise their salaries to the new requirement (if you elect this option, review employees' job duties to ensure they continue to qualify for the applicable exemption); or

Reclassify the employees

Reclassify the affected employees as non-exempt and pay them overtime whenever they work more than 40 hours in a workweek

These options are discussed in greater detail on the next page.

How to Comply with the New Overtime Rules

Option 1: Raising Salaries

If an employee's salary is closer to the current minimum ($23,660) and they rarely work overtime, it might make sense to reclassify them as non-exempt. To determine the cost of raising an employee's salary to the new minimum, simply subtract the employee's current salary from the new minimum ($47,476).

Note: If you provide your exempt employees with nondiscretionary bonuses, incentive payments or commissions, make sure you factor this in when calculating the potential costs of raising their salaries to meet the new requirement (10 percent of these payments can be used to meet the minimum salary threshold).

Beyond the costs of raising exempt employees' salaries, consider the impact on internal pay equity. Internal equity means employees are paid fairly when compared with other employees within your company. If you substantially increase some employees' pay, other employees may have questions about why their pay isn't increasing.

Also remember that with the automatic increases, you would need to review and adjust (if necessary) exempt employees' salaries every three years. If you currently offer regular merit increases, you will need to decide how you will handle those going forward in light of the automatic adjustments.

Option 2: Reclassifying Employees

If exempt employees don't meet the new salary requirement, you can **reclassify them** as non-exempt and pay them overtime (1.5 times their regular rate of pay) whenever they work more than 40 hours in a workweek. If your employees rarely work more than 40 hours in a week, you could reclassify them as non-exempt and convert their salary to an hourly wage (divide their weekly salary by 40 hours).

If your employees regularly work more than 40 hours per week, simply converting their salary to an hourly wage would result in a significant increase in costs. However, assuming you have an accurate picture of the hours they work, you could keep your costs the same by accounting for the overtime premium in their new hourly wage. To take this cost-neutral approach, here is a simple formula you can use:

$$\frac{\text{Weekly Salary}}{[40 \text{ hours} + (\text{Overtime Hours Worked Per Week} \times 1.5)]}$$

How to Comply with the New Overtime Rules

For example, an exempt employee's current salary is $715 per week, the employee regularly works 50 hours per week, and you want to convert this employee to an hourly employee but keep your costs the same. You would calculate the hourly wage as follows:

$$\frac{\text{\$715 weekly salary}}{[\text{40 hours + (10 overtime hours x 1.5)}]} = \text{\$13 hourly rate}$$

This employee would be paid $13 per hour for the first 40 hours and $19.50 per hour ($13 x 1.5) for each hour of overtime. Remember, whatever hourly rate you decide to pay reclassified employees, it must meet or exceed the highest applicable minimum wage (federal, state, or local).

Use our **calculator** to help you estimate and compare the costs of the options covered above. After evaluating your options, make appropriate salary or classification adjustments by December 1, 2016.

How to Reclassify Employees

You may have questions about how to reclassify your exempt employees in light of the new rules. Here we answer some frequently asked questions.

Q: How can I determine whether it will cost me less to raise the employee's salary or reclassify the employee as non-exempt?

A: Here are some guidelines to help you with this cost analysis:

- Get an accurate picture of the hours exempt employees typically work per week. If you underestimate their hours and reclassify them as non-exempt, your overtime costs would be more than you anticipated.
- If you haven't already done so, conduct a time study (ask exempt employees to start tracking their time and/or ask the employees and their supervisors how many hours they typically work per week).
- Factor in peak periods for your business and all the time that is considered "hours worked" under the FLSA, such as certain time spent traveling and in training.
- Use our calculator to estimate the costs of raising salaries versus reclassifying employees.

Q: What do you mean by factoring in all the time that is considered "hours worked" under the FLSA?

A: Under the FLSA, **hours worked** includes not only productive time (time actually spent working) but also certain nonproductive time, such as rest breaks, travel time, and training time. If you reclassify employees as non-exempt, all of this time must be included when determining whether you have met the minimum wage requirements and whether overtime is due. For example, if your exempt employees do a lot of business travel, this could result in significant overtime hours (and costs) if you were to reclassify them as non-exempt.

How to Reclassify Employees

Q: For non-exempt employees, what is the overtime rate?

A: Under federal law, the overtime rate is 1.5 times the employee's regular rate of pay. An employee's "regular rate of pay" includes their hourly rate plus the value of nondiscretionary bonuses, shift differentials, and certain other forms of compensation. However, there are certain types of compensation that are excluded from the **regular rate of pay**.

Note: Depending on the circumstances, some states have different overtime rates. For instance, California requires two times an employee's regular rate of pay for all hours worked over 12 in a workday.

Q: What is a nondiscretionary bonus?

A: Nondiscretionary bonuses are generally defined as those announced or promised in advance to induce employees to work more efficiently or to remain with the company. Examples include bonuses for meeting set production goals, retention bonuses, and commission payments based on a fixed formula. Most bonuses are considered nondiscretionary. By contrast, discretionary bonuses aren't announced or promised in advance. For example, if you decide at the end of the year to surprise employees with a bonus, this would generally be considered a discretionary bonus.

Q: I would like to use the cost-neutral approach to reclassifying employees. What happens if I do this but they work less overtime than I anticipate? Would I have to provide them with extra pay so they receive the same amount as when they were exempt?

A: Once you have an accurate picture of the hours your exempt employees work, you can use the cost-neutral approach to convert their salary to an hourly wage. This method allows you to factor in the overtime premium. If you use this approach when converting an exempt employee's salary to an hourly wage, you wouldn't be required to pay for shortfalls that result solely from an employee working less overtime than you anticipate. However, a significant reduction in pay after reclassification could result in employee morale issues. Consider how you will handle these types of scenarios should they arise.

How to Reclassify Employees

Q: If our company decides to reclassify one employee, do we have to use that option for all exempt employees who earn less than the new minimum?

A: Generally, this decision should be made on a per-employee basis, meaning you can choose one option for some employees and another for other employees. Consider factors such as the employee's current salary, the number of hours the employee typically works per week, and whether or not the employee travels for work.

Q: Can I continue to pay impacted employees a salary after I reclassify them as non-exempt?

A: If you reclassify employees as non-exempt, you can still pay them a **salary** as long as they receive at least the minimum wage for each hour worked and overtime pay whenever they work more than 40 hours in a workweek. Remember, you will need to track their hours closely to ensure you pay overtime in accordance with the law.

Q: Can I have a policy that prohibits employees from working overtime without prior approval?

A: You can implement a policy that prohibits employees from working overtime without prior approval, but if they do work more than 40 hours in a workweek, you must pay them overtime.

Note: Some states also require overtime for all hours worked over eight in a workday. Check your state law for more information. If employees violate your policy, you can discipline them, but you may never withhold overtime pay.

Q: Can I just pay overtime to non-exempt employees at a flat sum instead of calculating it each week? For example, I know that if I pay my employees a flat sum of $500 each week for overtime, this will cover any and all overtime they work in a workweek.

A: No. You must calculate and pay overtime to non-exempt employees on a per-hour basis. You may not pay employees a flat sum for all overtime worked, even if it would be greater than what is owed on a per-hour basis.

How to Reclassify Employees

Q: Can I offer time off to employees instead of overtime? For example, can I give an employee 1.5 hours off for each overtime hour instead of extra pay?

A: This practice is commonly known as "comp time" and it is prohibited in the private sector. Non-exempt employees who work more than 40 hours in a workweek must receive overtime pay.

Q: When reclassifying an employee as non-exempt, can I transfer some of the employee's duties to a part-time employee to limit the reclassified employee's hours to 40 per week?

A: Transferring duties of a non-exempt employee to another employee continues to be one of the options employers have for reducing overtime costs. In fact, the Department of Labor highlighted this option when announcing the new overtime rules. When weighing this approach, consider whether adding part-time employees or increasing the hours of existing part-time employees would subject your company to additional requirements under other laws, such as the Affordable Care Act.

Q: Many of my exempt employees haven't tracked their hours for years. Now I plan to reclassify them as non-exempt and need them to accurately track their hours. What can I do to help with the transition?

A: Here are several best practices for non-exempt employees:

- Provide training on your timekeeping policies and on using your timekeeping system.
- Direct them to record all of the time they work and expressly prohibit off-the clock work (however, if they do perform off-the clock work, you must pay them for that time).
- Consider controls to prevent off-the-clock work (e.g., limiting remote access to work email).
- Inform them that they should report any missed punches immediately.
- Require them to punch out for unpaid meal periods.
- At the end of each payroll period, require them to confirm their hours of work.
- Closely monitor compliance with your timekeeping rules and practices.

Make sure you understand the full impact of whatever option(s) you choose in order to comply with the new overtime rules. Once you have a plan, decide how you will **communicate the changes** to your employees.

How to Communicate Overtime Changes to Employees

Once you have evaluated your options, develop a plan to communicate any changes to your employees. Here are some communication strategies to consider:

Act now.

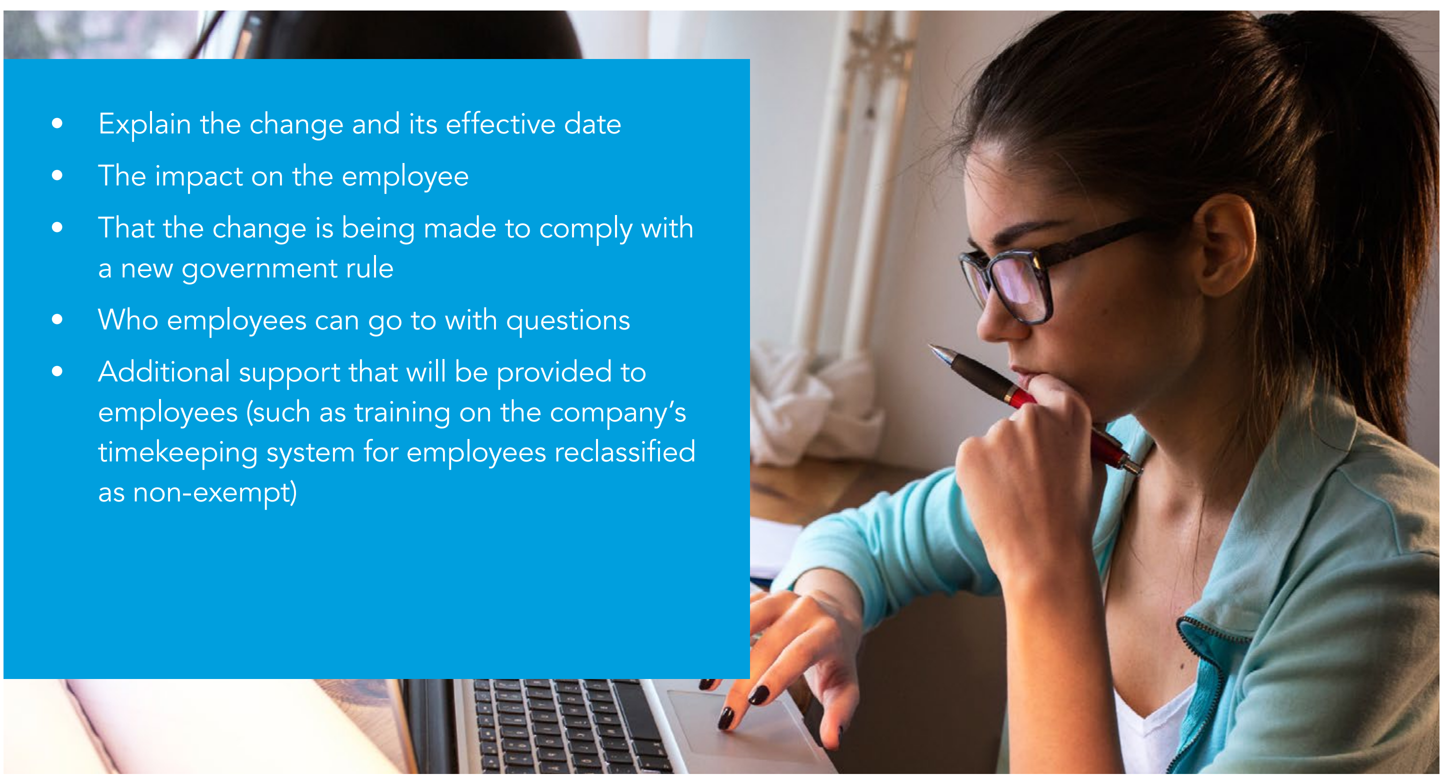
Given the amount of attention the final rules have received, employees may start to ask questions about how they will be impacted. You have some time to weigh your options and make a decision. Let employees know that you are currently evaluating the impact and will notify them after you've assessed your options.

Comply with notice requirements.

Some states require employers to provide advance notice about pay changes. For example, Missouri generally requires at least 30 days' notice before a reduction in pay. Generally, California requires written notice of any pay change within seven days. Nevada, New York, and South Carolina require written notice seven days before a reduction in pay. Other states have different timelines, including notice at least one pay period in advance. Check your state and local law to ensure compliance. In the absence of a specific notice requirement, provide written notice as soon as possible.

Develop your message carefully.

Your message will not only help employees understand the changes, but it can also help to shape their perception of the change. This is especially true for reclassified employees who may view the change as a demotion. When drafting your message, be sure to address the following:



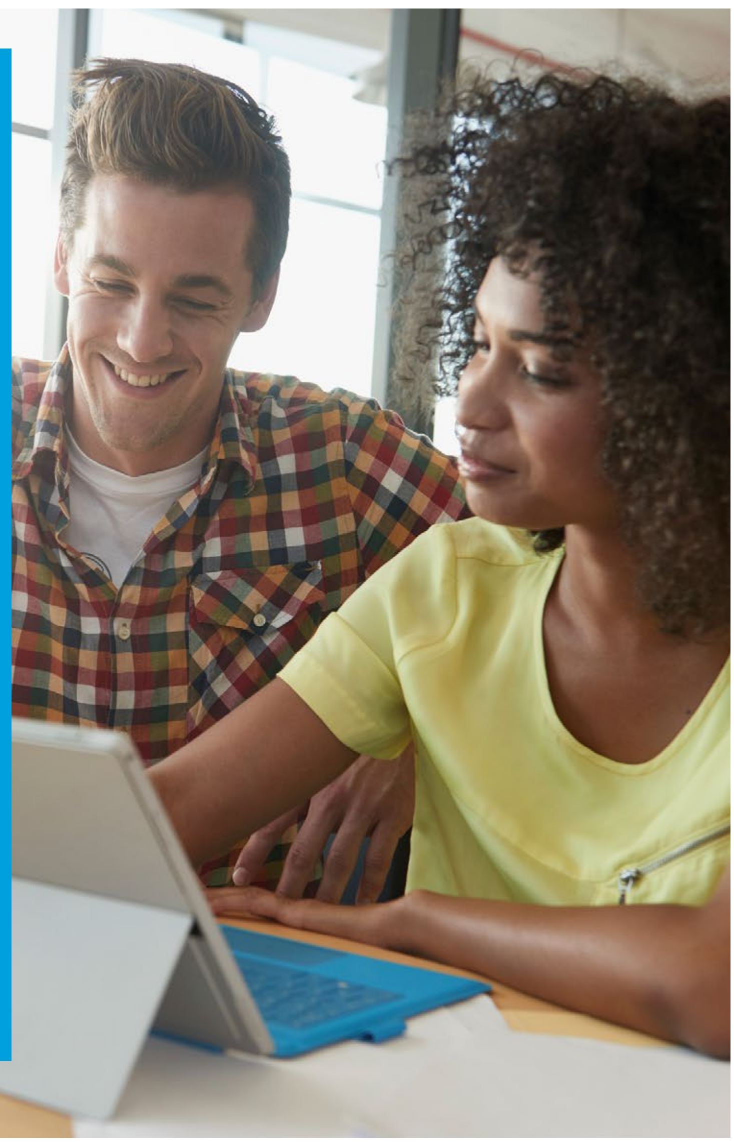
- Explain the change and its effective date
- The impact on the employee
- That the change is being made to comply with a new government rule
- Who employees can go to with questions
- Additional support that will be provided to employees (such as training on the company's timekeeping system for employees reclassified as non-exempt)

How to Communicate Overtime Changes to Employees

Pay special attention to reclassifications.

Many employees attach a certain level of prestige and flexibility with being classified as exempt. If you reclassify employees (see ***FAQs on Reclassification***) as non-exempt, they may see it as a demotion. You can try to address this perception by reiterating that the changes are necessary to comply with the law (and not an indication of a reduced status within the company). You may also choose to reclassify impacted employees, but continue to pay them on a salary basis. However, **overtime pay** is still required for all hours worked over 40 in a workweek. Additionally, explain the benefits of being classified as non-exempt, such as a potentially improved work/life balance, or receiving overtime pay whenever they work more than 40 hours per week. More often than not, exempt employees are already working over 40 hours per week and don't receive additional compensation for this time.

Reclassified employees may also ask about:



Changes in Pay

When converting their salary to an hourly wage, consider the cost-neutral approach, which factors in anticipated overtime hours.

Overtime Policies

Most employers require employees to obtain authorization before working overtime. Regardless of your policy, all overtime must be compensated, even if it was not authorized in advance.

Timekeeping

Address the system your company uses to track time, whether or not employees are expected to punch in and out for meal periods, and exactly what time must be accounted for.

Benefits

Some employees may wonder if their benefits package is impacted by the change. Typically, an employee's status as full-time or part-time impacts their benefits, not whether or not the employee is exempt from overtime.

How to Communicate Overtime Changes to Employees

Train supervisors and employees.

Train supervisors so that they provide information consistent with your company's policies and messaging. Since many exempt employees aren't accustomed to tracking their hours, train reclassified employees to record their hours accurately. Under the FLSA, **hours worked** includes not only productive time (time actually spent working), but also certain nonproductive time, such as rest breaks, travel time, and training time. All of this time must be included when determining whether you have met your minimum wage and overtime obligations.

Exempt employees may also be used to working after hours, including making phone calls and checking email. Supervisors play an important role in preventing off-the-clock work. Ensure supervisors set proper expectations with their staff and that they are prepared to monitor this time. Consider controls, such as preventing access to work email outside of business hours, or requiring permission before performing work during off hours.

Prepare for difficult conversations; don't prohibit pay discussions.

The new rules may present some difficult decisions for employers. For example, if you raise the salaries of some employees to comply with the new rules, other employees may have questions about why their pay isn't increasing or why they are being reclassified as non-exempt instead.

In an attempt to prevent discord, some employers might contemplate a policy prohibiting employees from discussing their pay with co-workers. However, prohibiting pay discussions is not permitted under **Section 7 of the National Labor Relations Act** (NLRA). Section 7 gives employees the right to act together, with or without a union, to improve wages and working conditions. Workplace rules or policies that could be construed to prohibit employees from discussing pay, benefits and other terms and conditions of employment could violate Section 7.

Before December 1, 2016, employers will need to decide how they will comply with the new rules and communicate changes to impacted employees. Given the publicity surrounding the final rules, develop your communication plan as soon as possible.

Bonuses & The New Salary Requirement

Here are answers to some frequently asked questions about bonuses and incentive payments as they relate to the new overtime rules.

Maximum nondiscretionary bonus or incentive payment that can apply toward the minimum salary requirement.

$91.30

(10 percent of $913)

Q: What is changing about bonuses with respect to the administrative, professional, and executive exemptions?

A: Beginning December 1, 2016, employers may use nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10 percent of the minimum salary requirement for the administrative, professional, and executive exemptions, as long as these forms of compensation are paid at least quarterly. This means that the maximum nondiscretionary bonus or incentive payment that can apply toward the employee's weekly minimum salary is $91.30 (10 percent of $913). Previously, employers were prohibited from counting any portion of these forms of compensation toward meeting the minimum salary requirement.

Employers may use **nondiscretionary bonuses & incentives** to satisfy up to **10% of the minimum salary requirement** for the administrative, professional, and executive exemptions.

Q: What are nondiscretionary bonuses?

A: While the final rules don't define nondiscretionary bonuses, the DOL has said that nondiscretionary bonuses are generally announced or promised in advance to induce employees to work more efficiently or to remain with the company. Examples include bonuses for meeting set production goals, retention bonuses, and commission payments based on a fixed formula. Most bonuses are considered nondiscretionary. By contrast, discretionary bonuses aren't announced or promised in advance. For example, if you decide at the end of the year to surprise employees with a bonus, this would generally be considered a discretionary bonus. Discretionary bonuses may not be counted toward meeting the minimum salary requirement.

Q: Does the new rule regarding nondiscretionary bonuses apply to highly compensated employees?

A: For the highly compensated employee exemption, employers are already allowed to include commissions, nondiscretionary bonuses, and other nondiscretionary compensation toward meeting the total annual compensation requirement. In fact, these types of payments often make up a large percentage of the highly compensated employee's compensation. This doesn't change under the final rules. As long as the employer pays highly compensated employees at least $913 on a weekly salary basis, the employer can count these other forms of compensation toward meeting the minimum total compensation requirement ($134,004 per year).

Bonuses & The New Salary Requirement

Q: Can I change from discretionary bonuses to nondiscretionary bonuses so I can count them toward the minimum salary required?

A: By definition, discretionary and nondiscretionary bonuses are designed for different purposes. Discretionary bonuses are not disclosed in advance, whereas a nondiscretionary bonus is predetermined based on set criteria. If you intend to introduce a nondiscretionary bonus program, make sure you decide in advance the specific criteria for the bonus, apply your criteria consistently, and communicate bonus requirements to employees.

Q: How does the rule work if I don't pay bonuses every week?

A: As long as you pay the employee a nondiscretionary bonus at least quarterly plus a weekly salary of at least $821.70 (90 percent of the minimum), then you can generally take advantage of this rule. For example, if you pay the employee $821.70 per week and a bonus of $1,186.90 ($91.30 x 13 weeks) every 13 weeks, it would equal the same amount as if you had paid your employee a salary of $913 per week.

Q: What if my employee doesn't meet their sales quota and they don't earn their expected quarterly commission?

A: You would have to make a catch-up payment. Employers may make a catch-up payment no later than the next pay period after the end of the quarter where the bonus or commission was less than anticipated and the employee's salary plus bonuses and commissions for the quarter does not equal or exceed 13 times the minimum weekly salary of $913. The catch-up payment counts only towards the prior quarter's salary, and not toward the salary in the quarter in which it was paid.

Let's say you reasonably anticipated that the employee would earn a commission of at least $2,000 every quarter. Therefore, you pay the employee a weekly salary of $821.70 and intend to apply the maximum amount of the commission toward meeting the salary requirement ($91.30 per week). However, the employee has a poor quarter and earns a commission of only $1,105 (or $85 per week). This would mean the employee only earned $906.70 on a per-week basis during the quarter ($821.70 salary + $85 commission), $6.30 less than is required. To maintain the employee's exempt status, you would need to make a catch-up payment of $81.90 ($6.30 x 13) to bring the employee's compensation up to $913 on a per-week basis.

$821.70 weekly salary + **$85** commission = **$906.70** + **$6.30** catch-up payment = **$913**

Q: What if I decide not to make the catch-up payment?

A: If an employer does not make the catch up payment, the employee would be entitled to overtime pay for any overtime hours worked during the quarter in which the employee did not receive at least the minimum salary requirement.

Bonuses & The New Salary Requirement

Q: What does it mean that nondiscretionary bonuses must be paid at least "quarterly?" Is it the calendar quarter? Fiscal quarter?

A: It means the time between such payments must be 13 weeks or less. Employers can decide when the quarter begins, and then the bonus payment must be made by the end of that quarter to count toward the minimum salary requirement. For example, if you would like to capitalize on the rule from day one, your first bonus payment would generally need to occur within 13 weeks of December 1, 2016.

Q: What if my company's quarter for bonus purposes will start on January 1, 2017, not December 1, 2016?

A: You must generally make your bonus payment within 13 weeks of January 1, 2017 for it to apply toward 10 percent of the minimum salary requirement *during that time period*. From December 1, 2016 through December 31, 2016, you would be required to pay the full minimum of $913 per week.

Q: Can I start applying bonuses toward meeting the minimum salary requirement for the administrative, professional, and executive exemptions before December 1, 2016?

A: No. The new rules take effect December 1, 2016.

Q: What happens when the minimum salary requirement is automatically adjusted in three years?

A: Employers may apply nondiscretionary bonuses and other incentive payments toward meeting up to 10 percent of that new amount.

Q: My company pays for the full cost of health insurance for all employees. We also provide lodging and meals to some employees. Can I count these and other benefits toward meeting the minimum salary requirement for exemption?

A: Only a direct salary and nondiscretionary bonuses and other incentive payments may count toward meeting the minimum salary requirement.

> Employers that offer, or plan to offer, nondiscretionary bonuses and other incentives payments to exempt employees should evaluate how the new rules will affect their compensation practices. The DOL plans to provide additional guidance prior to December 1.

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For more information:
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