Changes in Overtime Regulations Expand Eligibility

Implications of the Final Rule

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EXECUTIVE SUMMARY

The Fair Labor Standards Act of 1938 (FLSA) sets standards that affect workers in all industries, including federal benchmarks and protections for minimum wage, child labor, discrimination and overtime. The regulations that pertain to overtime were recently revised through the Department of Labor’s Final Rule that was published on May 23, 2016 (and effective December 1, 2016). The Department revised the regulations related to FLSA’s overtime provisions in response to President Obama’s March 13, 2014 Presidential Memorandum directing the Secretary of Labor to propose revisions that modernize and streamline the existing overtime regulations because the exemptions for executive, administrative and professional (EAP) employees did not keep up with the changing economy, resulting in millions of Americans lacking overtime protections.

The Final Rule retains much of the controlling regulations that carry out the FLSA without modification, though the changes it does make substantially alter the overtime eligibility requirements. Of the three main tests employers use to assess employee overtime eligibility (i.e., salary basis, salary level and job duties), only the salary level is explicitly changed in the Final Rule by increasing the threshold in place since 2004: $455 weekly ($23,660 annually) to $913 weekly ($47,476 annually). The Department estimates that at least 4.1 million workers will become eligible through this change alone, which has traditionally been the most objective barrier to salaried employees accessing overtime compensation. Other changes stemming from the Final Rule include the ability of employers to satisfy up to 10 percent of the salary level test through specific types of frequently (quarterly or more) given bonus, incentive and commission payments and provisions for automatic updates of the standard and Highly Compensated Employee salary level thresholds, which will change every three years based on Bureau of Labor Statistics (BLS) data. Unfortunately, the Final Rule does not significantly simplify the requirements for overtime eligibility. There is active opposition to the Final Rule in Congress, making the December 1, 2016 Final Rule effective date somewhat tenuous.

CURRENT REGULATORY SUMMARY FOR OVERTIME EXEMPTION

The FLSA requires employers to pay overtime, or wages equivalent to at least one and one-half regular rates of pay for any time worked in excess of 40 hours in a workweek. However, some employees can be classified by their employers as exempt from FLSA’s overtime requirements if they satisfy certain requirements. These requirements are collectively known as the “white collar” or Section 13(a)(1) exemptions because they apply only to employees that acquire their skills through prolonged coursework. The exemptions do not apply to manual laborers or workers that acquire their skills through apprenticeships and on-the-job training, regardless of the training required or salaries paid (e.g., electricians, plumbers, police officers, paramedics, firemen, etc.).

The white collar exemption requirements fall into three distinct categories: salary basis, salary level and job duties. The employee must meet all three requirements for the employer to apply the exemption.

Salary Basis Test

The first requirement, known as the salary basis test, requires exempt employees to be salaried, receiving a predetermined and fixed amount of compensation on a weekly (or less frequent) basis.
Salary Level Test

The second requirement, known as the salary level test, requires the employee to be paid more than a specified level (currently $455 per week). Equating to a $23,660 annual salary, this is less than half of the national median weekly rate of $1,146 ($59,592 annually) for salaried workers. It is also less than twice the poverty level for a single person ($11,880) and is considered impoverished for a family of four ($24,300). These numbers are important because they are referenced in the calculations that determine eligibility for several social assistance programs, including Medicaid, Supplemental Nutrition Assistance (SNAP), Temporary Assistance for Needy Families (TANF), the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC), and school meal subsidies. The Final Rule’s supplemental commentary states that increasing the $23,660 salary level, which has not changed since 2004, will reduce social assistance expenditures. Other benefits noted in the Final Rule’s commentary include strengthening overtime protection for other workers, reducing litigation and improving the health, work-life balance and productivity of workers.

Duties Test

The final requirement, known as the duties test, requires the employee to perform primarily executive, administrative, or professional (EAP) duties. Employers cannot satisfy this component by reviewing job titles alone; rather, an employee’s specific activities govern whether this requirement is met.

The executive duty is met when an employee’s primary job function involves managing the entity or a department/division within it. The employee must regularly direct the work of at least two other full-time employees and have the authority to hire or terminate staff.

Administrative duties occur when the employee performs office or non-manual work related to the management or general business operations of the employer or the employer’s customers and the employee exercises “discretion and independent judgment” in carrying out important decisions. This type of work must relate directly to the running of a business, and cannot include working on a production line or selling goods at a retail establishment. Work that would apply includes, but is not limited to, the fields of finance, accounting, quality control, procurement, marketing, human resources, database administration, compliance and others.

The professional exemption can be used for learned or creative professionals, and the tests are based on whether the employee’s work requires either advanced intellectual knowledge or originality, respectively. It is worth noting that teachers and physicians, including medical residents, are categorically exempt from FLSA’s overtime payment requirements. The traditional EAP duties test also extends to computer employees and outside sales staff (with additional criteria applicable to each). As noted earlier, manual laborers or other “blue collar” workers that use physical skill and energy to complete their work almost always remain eligible for overtime, as do police officers, firefighters and paramedics.

The duties test effectively allows employees to work more than 40 hours a week without overtime pay so long as they are salaried, paid more than $455 per week ($23,660 per year) and perform primarily executive, administrative or professional duties.
REGULATORY REVISIONS TO OVERTIME EXEMPTION

The Final Rule addresses a major barrier that prevents employees from receiving overtime compensation: the outdated salary level. The salary basis and duties tests remain unchanged, but the Final Rule increases both the standard salary level and the highly compensated employee salary level. Other changes include automatic updates to the salary levels every three years and the inclusion of up to 10 percent of certain bonus, incentive and commission payments to be included in the salary level test.19 This section will focus on the revisions to the salary level (see Additional Implications to Consider for more information on the automatic updates and bonuses).

The salary threshold will more than double on December 1, 2016 from $455 per week ($23,660 annually) to $913 per week ($47,476 annually). Highly compensated employees also increase from $100,000 to $134,004 annually. These are fiscal year 2015 figures published by the BLS, and they were based on several stakeholder sessions and public comments. Following the President’s March 13, 2014 Memorandum, the Department engaged in several meetings with more than 200 organizations to determine the appropriate salary level, potential changes to the duties tests and ways to simplify the regulations.20 When the Department published its Notice of Proposed Rulemaking on July 6, 2015, more than 270,000 individuals and organizations commented on the proposed changes during the 60-day comment period (which ended on September 4, 2015), with the overwhelming majority of comments advocating for an increased standard salary level.21 The Department initially proposed a 40th percentile of weekly earnings of full-time salaried workers nationally, which amount to $970 per week ($50,440 annually).22 The Department lowered this amount to $913 per week ($47,476 annually) in response to comments that the proposed national standard would make many EAP employees in low-wage areas eligible. This level is derived from the lowest-wage Census Region, which in 2015 was the South. The South region actually includes the District of Columbia and 16 states ranging from Texas and Florida, to Maryland and Virginia. The table below summarizes the BLS figures used in the Final Rule’s salary level.

Table 1: BLS Weekly Earnings of Non-Hourly Full-Time Workers (2015Q4)

<table>
<thead>
<tr>
<th>Region</th>
<th>Weekly Earnings (40th Percentile)</th>
<th>Annual Equivalent</th>
</tr>
</thead>
<tbody>
<tr>
<td>West</td>
<td>$1,050</td>
<td>$54,600</td>
</tr>
<tr>
<td>Northeast</td>
<td>$1,036</td>
<td>$53,872</td>
</tr>
<tr>
<td>Midwest</td>
<td>$994</td>
<td>$51,688</td>
</tr>
<tr>
<td>South</td>
<td>$913</td>
<td>$47,476</td>
</tr>
<tr>
<td>National</td>
<td>$972</td>
<td>$50,544</td>
</tr>
</tbody>
</table>

The new threshold means that EAP employees earning less than $47,476 annually will be eligible for overtime regardless of their job duties. Unsurprisingly, the comments from employees advocated for a higher threshold while employers stated that the proposed salary level was too high.23 The Department responded by stating that using the lowest-wage salary level “is practicable over the broadest possible range of industries, business sizes and geographic regions.” 69 FR 22171 (citing Kantor Report at 5).24 The Department is most concerned with the adverse impact a higher level would have on low-wage regions; therefore, it considers the lowest-wage region at the 40th percentile level to be the “best dividing line between
employees who are overtime eligible and those who may not be overtime eligible, when paired with the standard duties test.\textsuperscript{25}

The salary level’s impact is undoubtedly substantial but estimates do vary. The Department estimates that 4.1 million salaried workers will become eligible for overtime based on the new $47,476 salary level, resulting in approximately 13 million workers eligible for overtime pay nationwide.\textsuperscript{26} The Department expects another 100,000 workers to receive salary increases that surpass the new level. The Economic Policy Institute estimates higher numbers with 12.5 million workers expected to benefit from the Final Rule, with 12.5 million representing the number of workers earning more than $455 but less than $913 per week.\textsuperscript{27} The Department also estimates that this rule change will directly cost employers up to $255.3 million annually (and possibly another $1.27 billion indirectly).\textsuperscript{28} The Florida Department of Economic Opportunity estimates that the cost to Florida employers will be $1.7 billion annually.\textsuperscript{29}

**IMPLICATIONS FOR HUMAN SERVICES ORGANIZATIONS**

As the primary providers and purchasers of human services, state and local governments will have to figure out how to comply with these new rules, including the impact on their contracted networks of private human services providers.

The Final Rule’s overtime provisions may apply to nonprofit entities, which include many health and human services providers.\textsuperscript{30} Employees can be covered under FLSA’s minimum wage and overtime protections through enterprise or individual coverage.\textsuperscript{31} Enterprise coverage means that FLSA applies to all employees of the business if the business has at least $500,000 in annual sales; nonprofit charitable organizations that do not engage in ordinary commercial activities are not considered covered enterprises. Therefore, many nonprofit organizations may not be covered enterprises under FLSA.\textsuperscript{32} This does not rule out employee eligibility for overtime completely. Employees may then be eligible for individual coverage if they are engaged in interstate commerce.

There are four broad types of business that are considered covered enterprises for FLSA: hospitals, businesses providing medical/nursing care, schools, preschools, and government agencies.\textsuperscript{33} State and local governments will also need to continue to comply with the FLSA, which was extended to state and local governments by the Supreme Court in 1985 (and resulted in that year’s Congress amending the FLSA to allow governments to use some compensatory time in lieu of overtime payments).\textsuperscript{34}

FLSA sets minimum standards that all employers must comply with, but states still maintain (and often exercise) autonomy to enact more stringent labor requirements. For example, 29 states currently require higher minimum wages than the $7.25 minimum wage, and employers must comply with both applicable state and federal laws related to minimum wage and overtime (with at least 11 states referencing or incorporating FLSA directly by regulation).\textsuperscript{35, 36}

Some affected human services organizations will have additional time to comply with the new regulations. There will be an additional 28-month grace period for covered nonprofits and nonprofits with eligible employees that provide Medicaid-funded services for individuals with intellectual or developmental disabilities in residential homes and facilities with 15 or fewer beds.\textsuperscript{37} Private entities, nonprofit and for-profit alike, are bound by the terms of their contracts with state and local government agencies, which may mandate compliance with labor laws akin to the FLSA. Therefore, every employer and employee must be uniquely assessed for FLSA coverage.

Options for complying with the rule include raising salaries, paying overtime, and/or modifying employee workloads or staffing levels, all of which have cost implications. As large purchasers of human services, it may be challenging for state and local government agencies to understand the cost impact on their contracted networks of private human services providers but they will need to work with providers to understand how costs will change and determine whether rate or contract adjustments are necessary.
ADDITIONAL IMPLICATIONS TO CONSIDER

Automatic Salary Level Updates

Another critical change stemming from the Final Rule is the new automatic updating of the standard salary level every three years.38 The standard level will be updated to the 40th percentile of weekly earnings of full-time salaried workings in the lowest-wage Census Region. The Highly Compensated Employee level will also update automatically every three years (to the 90th percentile of annual earnings). These rates will be published in the Federal Register 150 days before their effective date (which will first occur January 1, 2020). The automatic updates will prevent the revised figures from becoming less meaningful in future years. For example, the last update before 2004 occurred in 1975, and in those 29 years without a salary adjustment, the federal minimum wage amount ($5.15 in 2003) actually surpassed the previously used white collar long-test salary level (one of the precursors to the standard salary level test).39 The three-year updates will help curtail the inevitable erosion inflation has on salary levels used to determine FLSA overtime eligibility.

Inclusion of Bonuses, Incentives and Commissions

The Final Rule permits nondiscretionary bonuses to now count towards the standard salary test requirement.40 However, the Final Rule only allows nondiscretionary bonuses, commissions and incentive payments that are paid at least quarterly. These additional amounts also only count towards satisfying up to 10 percent of the standard weekly salary level test. Discretionary bonuses still do not count towards the salary level basis. In this labor context, discretionary means that the employer retains discretion to both the payment and amount, and there is no prior promise or agreement for the bonus.41 Holiday and special occasion bonuses may or may not be discretionary, but are regulated by the Department to not be included in regular payment rates or overtime calculations.42 Ultimately, only employers with frequent (more than quarterly) nondiscretionary bonuses will need to consider those payments when assessing whether overtime applies to employees. Nondiscretionary annual bonuses, holiday payments and other similar infrequent incentives will continue to fall outside of the FLSA’s overtime requirements and calculations.

CONCLUSION

There is opposition from several diverse stakeholders, businesses and associations. Congress also challenged the Final Rule with bills introduced in March 2016 (known as the Protecting Workplace Advance and Opportunity Act) in both the House (H.R. 4773) and Senate (S.2707). These could effectively override all of the Final Rule’s regulatory changes and force the Department to redo its revisions with greater deference given to the economic consequences and administrative simplicity associated with the regulatory changes.43

Public and private human services organizations should leverage focused and simplified resources (like this white paper) as supplements to information from the Department when determining the implications of the Final Rule for their service networks, payment rates, and employees. Human services organizations should also carefully review applicable state, local and contractual requirements to determine how FLSA and the Final Rule affect overtime eligibility for employees. The following federal resources can also help to enhance organizations’ understanding of the Final Rule.

Regulatory Resources and Guidance

• Overtime Exemption Regulations (29 C.F.R. § 541): http://www.ecfr.gov/cgi-bin/text-idx?tpl=/ecfrbrowse/Title29/29cfr541_main_02.tpl
• Department of Labor Fact Sheet #17A (EAP Exemptions under FLSA): https://www.dol.gov/whd/overtime/fs17a_overview.pdf

Resources for Nonprofits

• Department of Labor Factsheet for Nonprofits: https://www.dol.gov/sites/default/files/overtime-nonprofit.pdf

Resources for State and Local Government Entities

• Department of Labor Factsheet for States and Local Governments: https://www.dol.gov/sites/default/files/overtime-government.pdf

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4 29 C.F.R. § 541.3 (2016).
5 Id.
6 United States Department of Labor, Wage and Hour Division, Final Rule: Overtime, Questions and Answers, #3.
7 United States Department of Labor, Wage and Hour Division, Fact Sheet #17G.
10 Final Rule Published in Federal Register Vol. 81, No. 99, May 23, 2016, Supplementary Information, Page 32503.
11 Id.
12 United States Department of Labor, Wage and Hour Division, Fact Sheet #17A.
13 Id.
14 United States Department of Labor, Wage and Hour Division, Fact Sheet #17C.
15 Id.
16 United States Department of Labor, Wage and Hour Division, Fact Sheet #17D.
18 Final Rule Published in Federal Register Vol. 81, No. 99, May 23, 2016, Supplementary Information, Page 32396.
19 Id. at 32397.
20 Id. at 32403.
21 Id. at 32407.
22 Id. at 32409.
23 Id. at 32410.
29 United States Department of Labor, Wage and Hour Division, Fact Sheet #14A.
31 United States Department of Labor, Wage and Hour Division, Fact Sheet #14.
33 National Conference of State Legislatures, State Minimum Wages, April 4, 2016.
37 Bernstein, Jared and Eisenbre, Ross, New inflation-adjusted salary test would bring needed clarity to FLSA overtime rules, Economic Policy Institute, March 13, 2014.
40 Final Rule Published in Federal Register Vol. 81, No. 99, May 23, 2016, Supplementary Information, Page 32426.
42 Id. § 778.212.