

CLIENT ACTION Bulletin

Employee Benefits

DoL's Final Overtime Rule May Affect Retirement, Other Benefit Programs

SUMMARY The Department of Labor issued a final rule on the Fair Labor Standards Act's (FLSA) overtime pay requirements for most "white-collar employees," effective Dec. 1, 2016. Although the final rule focuses on paying time-and-a-half for hours worked in excess of 40 per week, it includes other new requirements that could have implications for sponsors of retirement plans (primarily 401(k) and similar arrangements), depending on the inclusion or exclusion of overtime pay and/or bonuses in the plan's formula for employer contributions. The final rule also might affect a retirement or other benefit plan's participation base, if salaried (exempt) employees are treated differently from hourly (nonexempt) employees, or it could raise concerns if the programs shift toward favoring the highly compensated.

DISCUSSION Overview of the FLSA

The FLSA establishes minimum wage, overtime pay, and recordkeeping requirements for employers. The law includes a "compensation" test that requires a minimum salary to qualify an employee for an exemption from the FLSA. The salary must not be subject to any reductions due to variations in the quality or quantity of work an employee performed. The FLSA also applies a "duties" test for an exemption, requiring that an employee's primary job duty involve certain qualifying responsibilities.

Because the FLSA covers workers who are "engaged in commerce or in the production of goods for commerce," nearly all employers – private, nonprofit, and governmental – are affected. Limited exclusions (e.g., for teachers) apply to certain educational institutions, as well as to "bona fide practitioners of law or medicine." In addition, the law exempts certain kinds of covered employees from the minimum wage and overtime requirements, including bona fide executive, administrative, and professional employees qualifying for the white-collar exemption. Employees who qualify as exempt from the FLSA's requirements need not be paid overtime for working more than 40 hours per week if they satisfy two conditions: they must be paid a predetermined and fixed salary level that is not subject to reduction because of variations in the quality or quantity of work performed; and their job duties must primarily involve executive, administrative, or professional duties.

Key Changes to the Current Rule

The final rule's changes to current regulations include:

- *Standard salary level* – Currently and since 2004, the standard salary level required for FLSA exemption is \$455 for a 40-hour week. The final rule raises the amount to \$913 per week (\$47,476 annually).
- *Highly compensated employee (HCE) salary level* – The total annual compensation level above which most white-collar workers will be ineligible for overtime increases from the current \$100,000 annually to \$134,004.
- *Automatic updates* – The salary thresholds will be adjusted every three years, beginning in 2020. The DoL projects that in 2020, the standard salary level will be \$51,168, while the HCE threshold will be \$147,524. The DoL will publish the updated rates by the Aug. 1 preceding the effective date.
- *Bonuses, incentive payments, and commissions* – The final rule allows nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10% of the standard salary test requirement, but only if these amounts are paid at least quarterly. Thus, nondiscretionary bonuses and incentives – such as those promised to employees for meeting production goals, to remain with the company, or to compensate them based on a fixed commission formula – must be paid quarterly to qualify toward the standard salary test.

Discretionary bonuses paid at the employer's sole discretion and not in accordance with predetermined standards cannot be used to offset the salary threshold.

The final rule makes no change to the "duties" test that exempts executive, administrative, professional, outside sales, and computer employees from the overtime pay requirement. These employees must satisfy certain tests concerning their job duties and must be paid at least the standard salary (i.e., \$913 per week beginning Dec. 1).

Options for Employer Compliance

The final rule allows employers to comply with the revised salary level through a range of options, including:

- *Raising salaries* – An employer may increase the salaries of employees who meet the duties tests, whose salaries are close to the new salary level, and who regularly work overtime, to at or above the salary level to maintain their exempt status.
- *Paying overtime above a weekly salary rate* – An employer may continue an employee's salary but pay overtime for hours in excess of 40 per week. An employer and an employee also could agree to a fixed salary for a workweek of more than 40 hours, with the salary including overtime pay under certain conditions such as a regularly scheduled workweek that exceeds 40 hours.
- *Reorganizing workloads, adjusting schedules, or spreading work hours* – An employer could schedule predictable work assignments at the beginning of the workweek, rather than late in the day on Friday for an employee who typically works Monday through Friday, to manage overtime hours. Employers also could hire new employees or redistribute work hours in excess of 40 across current staff who work less than 40 hours per week.
- *Adjusting wages* – Employers may adjust an employee's earnings to reallocate the amount between regular and overtime pay so that the total paid to the employee remains largely the same. An employee's hourly wage must not be reduced below the highest applicable minimum wage (federal, state, or local), or be continually adjusted each workweek to manipulate the regular rate.

Benefit Plan Implications

The final rule may have implications for sponsors of retirement plans, particularly 401(k) or similar plans that consider employee compensation (as well as nondiscretionary bonuses or incentives) when determining employer contributions. If the plan includes overtime pay in the contribution formula, sponsors' contributions could increase (depending on how the employer addresses compliance with the final rule). Plans that have definitions of compensation that exclude overtime pay could experience a bias toward HCEs, thereby resulting in nondiscrimination testing failures, if non-HCEs become newly eligible for overtime.

Similarly, employers sometimes offer certain benefits – such as different healthcare coverage or group life or disability insurance or vacation/paid time-off programs – to workers based on their job classification as hourly (nonexempt) or salaried (exempt) from the FLSA. If so, the benefit programs should be reviewed alongside the employee job classification process.

ACTION Given the significance of the final rule's changes, its impact on the workforce, and a fast-approaching deadline, employers are encouraged to consult with legal counsel and other professional advisers to discuss their options and strategies for implementing changes and ensuring compliance. Employers should review and revise their policies and procedures for job classification and benefit programs, and consider documenting their actions and decisions. Payroll and other administrative systems (e.g., work-time recordkeeping) should be assessed for readiness by the Dec. 1 effective date. In addition, employers should develop communications materials if changes adopted are likely to affect employees' pay, payroll taxes, benefits, work schedules, or job classifications.

For additional information about the DoL's final rule on overtime pay, please contact your Milliman consultant.