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What Companies Should Know About New Employee Overtime Rules in the United States

The US Department of Labor's new overtime rules, which go into effect near the end of 2016, will expand the percentage of the workers eligible for overtime pay from around 7% to 35%.

The United States federal government finalized its sweeping overtime pay proposal on May 18, 2016, which will dramatically increase the number of employees eligible for non-exempt status. After nearly a year since the proposal was first floated, the final rule struck some level of compromise with the business community: the pay threshold for eligibility will be $913 per week (or $47,476 annually) instead of $970 as originally proposed. And updates to keep the amount at the 40th percentile of full-time salaries in the lowest earning census region of the country are required every three years instead of annual updates as initially suggested. The new rules do not change the job duties requirement for exempt status (the Department of Labor's checklist of job duties for exempt status is available here).

The last adjustment to the salary basis test of the overtime pay rules was made in 2004 when the amount was increased to $455 per week. That covers a much smaller portion of the workforce today (around 7%) then when it was originally implemented as inflation and wages have increased. Under the new rules, an estimated 35% of the US workforce will now be eligible for overtime (time and a half rate of pay for hours worked in excess of 40 each week) even if their job title connotes a role of a manager or professional.

Companies have several months to prepare before the new rule goes into effect on December 1, 2016. The impact of the new rules on how companies operate is a topic of wide speculation. Will companies simply reclassify employees that qualify for overtime as non-exempt and pay the overtime costs required? While this may appear to be the easiest way to implement the new rules, it will likely necessitate changes to compensation budgets in other areas. Will companies decrease the number of working hours for employees that are now exempt to avoid incurring overtime costs? Perhaps yes, at least in some cases. Will employers increase the salaries of non-exempt workers to an amount above the new limit? Maybe. Other options might include splitting one person's job that is causing the overtime hours into two positions or shifting some duties to managers who are still exempt from overtime pay.

Another question to address is pay compression. What will companies do for exempt employees paid slightly above the new threshold rate? Might some companies convert additional employees to non-exempt status before that rate is raised in three years' time? While employees paid above, but near, $47,476 pass the current salary basis test for exempt status, they might earn less than their peers whose previously lower salary will translate to more total cash compensation because of newly received overtime compensation. These questions will be important for human resources and compensation professionals to sort out over the coming months as they impact every organization's workforce planning and budgeting differently.

The new rules are not only challenging for employers but they can present some "trade-off consequences" for employees converted to non-exempt status in companies where exemption from overtime pay provides additional rewards, including cash bonus plans, equity incentive opportunities and benefits that might only be offered to exempt staff. Furthermore, as companies more closely manage the hours of non-exempt employees, job flexibility and telecommuting may be limited to ensure compliance with limits on working hours as a means to managing overtime costs.

The hospitality, retail, and restaurant industries as well as non-profit organizations are expected to have the largest percentage of employees moving from exempt to non-exempt status, but a meaningful number of technology and life sciences companies will also be affected. While the federal government estimates that around 35% of the workforce will now be non-exempt, that figure is around 21% of the incumbents represented in the Radford Global Technology Survey and the Radford Global Life Sciences Survey. Of that group, more than 85% of the Radford Global Technology Survey incumbents and over 90% of the Radford Global Life Sciences Survey incumbents are already non-exempt; the number of people that earn between the old and new pay threshold is relatively small. Still, while the percentage of employees impacted is smaller than the national average, our analysis suggests that more than 37,750 current incumbents in our surveys will require a change in FLSA status or salary to comply with the new regulation.

For the curious, the change in regulation will not result in any structural changes to our surveys. The only expected changes within a survey input are to employee whose job duties change as part of a company's compliance efforts reflecting a match to a different survey job. Otherwise, pay or FLSA status changes will be reported normally.

To speak with a member of our compensation consulting group for more information about how the new federal rules will impact your organization, please write to consulting@radford.com. To learn more about participating in a Radford survey, please contact our team.

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