Aon Hewitt
Radford

October 2016

New Overtime Rules are Almost Here; Understand Your Options

Employees earning up to $47,476 a year are now eligible for overtime. With the salary threshold to be adjusted every three years, companies should carefully consider their options.

In March 2014, President Barack Obama asked the Department of Labor (DOL) to update its regulations around overtime protection in the Fair Labor Standards Act (FLSA), specifically the rules governing the exemption of executive, administrative and professional (EAP) employees from these protections. Historically, since 1940, the EAP exemption has applied when the following three tests are met:

- **Salary Basis Test:** The employee must be paid a predetermined, fixed salary each pay period that cannot be reduced for variations in quality or quantity of work performed
- **Salary Level Test:** The amount of salary paid must meet a minimum specified amount
- **Duties Test:** The employee's job duties must primarily involve executive, administrative, or professional duties as defined by the regulations

In response to the President's request, the DOL proposed regulation changes in July 2015, which included raising the Salary Level Test and re-calibrating this minimum amount automatically on an annual basis. These proposals raised a high level of concern within the business community. Many expressed that nearly doubling the Salary Level Test would have unintended consequences— like companies lowering base salaries or limiting employees' hours. While this rule makes many more employees eligible for overtime pay, it does not guarantee that these employees will earn overtime pay. On top of that, an annual automatic update to the salary level would create a near constant administrative burden of re-classifying jobs, people and their exemption status.

The DOL considered this feedback and presented final rule changes on May 18, 2016. The final rules include a new Salary Level Test set at $47,476 per year, or $913 per week, representing the 40th percentile of full-time salaried workers in the lowest-wage region of the US (currently the South). Non-discretionary incentive payments (including commissions) can satisfy up to 10% of the standard salary test requirement but they must be paid at least quarterly. Finally, updates to the Salary Level Test will occur every three years, rather than on an annual basis, pegged to the 40th and 90th percentile across the nation. Employers must be compliant with these new regulations by December 1, 2016. (Of note, 21 states filed a suit challenging the DOL's new overtime rules in late September. This case is still pending and could delay implementation; however, given the short timeframe between now and December 1, companies are advised to assume the rules will remain in effect as stated.)

As a side note, the newly adjusted highly compensated employee (HCE) annual salary threshold was raised to $134,004 from $100,000, representing the 90th percentile of full-time workers in the US. Some organizations have historically used the HCE exemption for their salespeople. The exemptions for sales roles are based on an individual transacting business away from the office. But in today's sales operating model, transactions are more frequently made over the phone than in person.

While the final rules represent a compromise between government and business, many organizations remain concerned about implementation. There are several approaches employers can take to comply with the new overtime rules, and the remainder of this article provides pros and cons for each option when considering compliance at your own organization.

Determine Eligible Employees

Before business leaders can assess their options for complying with the new overtime rules, the first step is to identify how many individuals and role types are impacted by the rules, in addition to how these people/positions might respond to being eligible for overtime pay. Human resources teams should begin to gather facts around:

- How many jobs and employees are potentially affected?
- Where are the jobs located?
- What is the existing culture around tracking time?
- Do job expectations change along with FLSA status?

The DOL estimates that 35% of the US workforce is eligible for overtime (time and a half rate of pay for hours worked in excess of 40 each week) under the new rules even if their job title connotes a role of a manager or professional. That figure is smaller for our technology and life sciences clients. Around 21% of the incumbents represented in the **Radford Global Technology Survey** and **Radford Global Life Sciences Survey** fall within the new salary threshold for overtime eligibility. Of that 21%, more than 85% of the our technology survey incumbents and over 90% of our life sciences survey incumbents are already non-exempt— meaning there will not be a change in the status quo for those individuals. While that is a relatively small percentage of total people affected by the new rules among our client base, a company's approach to compliance could have a bigger impact beyond the employees in question. For example, giving your newly overtime eligible employees a raise to lift them above the Salary Level Test could create pay compression issues and alienate a portion of your workforce as we discuss in greater detail below.

Evaluate Your Options

After you've begin to address the questions outlined above, the next action item is coalescing HR and business managers around an action plan for how to address employees newly eligible for overtime pay. There are a number of options businesses can pursue:

- **Raise pay to meet the baseline**. What is the estimated cost of giving across the board raises to employees now eligible? Is it more than what overtime would cost? What about others who don't get an increase? This opens up questions of fairness, job evaluation method, and why that job wasn't paid more to begin with. With pay equity front and center, will giving raises to meet the new salary level create additional areas of concern? Pay compression also becomes a factor, especially if the raises to meet the new baseline were significant. How will managers handle potential pushback from exempt employees? Clearly, this option opens the door to numerous considerations.

- **Transition the job to non-exempt status**. This is the easiest way not to carry the additional fixed cost of salary increases. Overtime is variable but it can be controlled. However, managing those costs can be difficult in areas where time spent has a direct correlation to business results. Examples include sales and jobs driven by customer satisfaction scores. Additionally, there is a new requirement to track time. "Exempt" is seen as a status by many employees. They don't have to track their time, they have flexibility in their schedule and their paycheck is the same every pay period. Moving them to nonexempt status can be viewed as a demotion even when they now receive overtime. Tracking time is especially difficult for those who work remotely, travel and those who need to "check in" via email during their non-working time. For employers with operations in multiple states, local regulations can complicate company policies. In California, non-exempt employees who work more than 8 hours in a day are eligible for overtime, which differs from many other states. As a company, do your policies change by state or are they consistent and meet the most stringent rules set forth?

- **Limit or actively manage overtime**. If you plan to limit overtime, you may need to evaluate productivity. Do those employees who regularly work 45 hours a week really need the extra time to complete their work? If so and you won't authorize overtime, who will do the extra work? Does it become more cost effective to offer overtime or hire more workers to complete the extra work? If not, how will they react to the additional pressure of getting their work done in a shorter period of time?

- **Re-assessing job duties and responsibilities**. Take advantage of this opportunity to re-evaluate the work employees are doing. Have lower level tasks crept up on some jobs so that incumbents are not working at the top of their skillset? Work can be restructured and the resulting jobs re-benchmarked. If there aren't any changes, you still have documentation to show you actually looked at the jobs and made informed decisions about changes in status and pay. The downside to re-assessing job duties is the significant amount of time and expertise it takes to effectively assess each job and develop job documentation.

Communicating and Managing Changes

An important aspect of implementing any new rule affecting your employees is communicating that change and what it means. Yet, this element is often overlooked or neglected. Regardless of the decisions you make for your workforce, all exempt and non-exempt employees and their managers will be affected in a variety of ways by new overtime rules. You'll need a proactive communication strategy to help prepare them for what's changing and to ensure your organization is able to manage through the change. Your goal is to create an environment for open communication and minimize negative impacts on productivity.

The following are recommendations for effective communication and change management:

- **Communicate honestly and specifically about potential changes to how people do their work.** Changes in employees' status can necessitate the need for changing working hours, scheduling, and your staffing mix (fewer non-exempt, etc.). Unknown changes include how employees plan for and complete their own work, and how they call on others for assistance and work together. Managers particularly should be prepared for potential impacts on staffing.

- *Approach:* Identify areas of the organization that may be more affected and prepare scenarios that demonstrate how to manage new ways of working.

- **Be prepared to manage overtime communication, planning and tracking.**
  Both exempt and non-exempt employees and their managers will need to know leadership's expectations for communicating with each other in planning for and tracking overtime. If you anticipate changes in overtime approvals, managers and employees need to be prepared for their roles.

  - *Approach:* Detail time recording and overtime approval processes as well as timing expectations for those. Develop and communicate your payroll timeline— particularly for the initial months after the change— including when time must be recorded and approved, when overtime approvals take place, etc.

- **Make sure your processes work, and be prepared for a transition period with compliance issues.**
  If any of your time recording or time tracking processes are difficult to explain, convoluted or require manual intervention, realistically assess those issues and do what you can to address them. Regardless of how your processes work, it's likely you will have a transition period with many more instances of non-compliance.

  - *Approach:* Prepare your managers and payroll staff to provide additional support and leniency as you ramp up to new procedures.

- **Be specific about how paychecks will be affected.**
  Employees now eligible for overtime may see larger or smaller paychecks and changes to payroll deductions for benefits premiums, 401(k)/403(b) contributions, garnishments, and other deductions. They may need to change when bills are paid automatically from their bank accounts. This is particularly important if they are moving from monthly to bi-weekly paychecks or are no longer eligible for overtime as their pay may be less each check.

  - *Approach:* Be specific about which deductions will adjust automatically and which ones they will need to adjust themselves. Provide specific instructions on how to make changes and when they need to be made. Remind them to check and adjust automatic bill payment. Remind them of the changes immediately before they receive first paycheck reflecting the changes.

- **Recognize that people will likely have paycheck questions.**
  Be sure that your payroll department and benefits team are ready for questions; employees may be looking at their paychecks closely when they have not done so in the past.

  - *Approach:* Recommend that employees access their last pay statement before the change and review it so they understand what will be changing— printing the statement if possible. Provide instructions on how to do that.

- **Clearly demonstrate to newly-exempt employees how their total pay will be affected.**
  Some newly-exempt employees may see their total pay or their pay opportunities decrease as they are no longer eligible for overtime. They may want to know how they can increase their pay.

  - *Approach:* Communicate specifically about pay opportunities for exempt employees and what it will take to increase pay. If they become eligible for short-term incentives, show examples of opportunities and when and how they are paid.

- **Avoid "benefits-speak" and technical terminology in your communication.**
  Terms like "FLSA" and "non-exempt" may not be familiar to your employees and may lead them to believe you are purposely not being clear. Dense language will lead to more need for support from call centers, HR and managers.

  - *Approach:* Start by explaining the current situation and what's changing and when in simple terms (e.g., "pay" instead of "compensation," "eligible for overtime" instead of "non-exempt"). It's okay to use "FLSA" in reference to what's changing— just be sure to explain what it means to employees in non-technical terms.

- **Accelerate employee and manager communication before and at the time of change.**
  You may need more information and communication than you are accustomed to. Also, HR teams should be prepared to update policy and process information on the intranet, in new hire materials and in manager training.

  - *Approach:* Consider creating a section on your intranet or a specific short-term website to house all information for managers and employees. Clearly delineate what is for managers and what is for employees. For employees whose status is changing, a home mailing may be most effective to ensure they complete transition tasks on time.

- **Equip many resources to answer questions.**
  HR professionals and team managers should expect to be key resources for information. Ask them to be fully knowledgeable of the content in organization-wide communications, conversant in how individuals will be affected, prepared to answer questions about individual impacts and ready for the emotions that arise with any change affecting pay and status.

  - *Approach:* Provide role-specific resources before, during and after your transition date.

- **Emphasize that a status change does not change an employee's standing in the organization.**
  Apart from a pay change, this can be one of the most challenging topics because it deals with how individuals feel about their jobs, how they view themselves in the organization and how they believe their leaders, peers and subordinates view them. For example, supervisors whose status is changing from exempt to non-exempt may feel that their standing in the organization and in relation to those they manage has changed.

  - *Approach:* Communicate to managers and employees about what's not changing: be clear if their roles, their duties, and their supervisors remain the same. Likewise, help them understand their career opportunities and value to the organization are not affected.

Next Steps

Planning for the new overtime rules is not going to be a quick and easy task for organizations, especially larger ones. There are several options to consider when deciding how to compensate individuals, classify their status and schedule their hours. Your decision needs to take into account a balanced view of different factors, including the direct cost to your business and the impact of changes on the productivity and engagement of your workforce (indirect costs).

Given that the Department of Labor will update the Salary Level Test every three years, the approach your company decides on now may set a precedent for what happens three years from now. What if the salary level goes up significantly again? Ask yourself whether the approach you decide to take today will be sustainable three years from now.

Once your company decides on its approach, your work is really just beginning. Business leaders, HR professionals and supervisors are all important constituents in the employee communication strategy, keeping in mind that it's not just the employees now eligible for overtime that could be affected by whatever action the company takes. An employee communication strategy must be in place prior to the new rules, with the expectation that there will continue to be questions and concerns from employees up to six months, or perhaps even longer, following the enactment of the new rules.

To speak with a member of our compensation consulting group about assessing and responding to US overtime rules, please write to consulting@radford.com.

Author Contact Information

Brooke Green
Partner, Radford
Aon Hewitt | Talent, Rewards & Performance
+1.415.486.6911
brooke.green@radford.com

Anne Lloyd
Partner, Communication
Aon Hewitt | Consumer Experience
+1.410.916.4754
anne.lloyd@aonhewitt.com

Dan Weber
Director, Radford
Aon Hewitt| Talent, Rewards & Performance
+ 1.408.321.2515
dweber@radford.com

Pam Hein
Partner, Communication
Aon Hewitt | Consumer Experience
+1.847.442.3814
pam.hein@aonhewitt.com

Cindy Edwards
Senior Consultant, Radford
Aon Hewitt| Talent, Rewards & Performance
+1.781.906.2299
cindy.edwards@radford.com

About Radford

Radford delivers compensation data and advice to technology and life sciences companies. We empower the world's most innovative organizations, at every stage of development, to hire, engage and retain the top talent they need to do amazing things. Today, our surveys provide in-depth compensation insights in more than 80 countries to 3,000 participating organizations and our consultants work with hundreds of firms annually to design rewards programs for boards of directors, executives, employees and sales professionals. Radford is part of Aon Hewitt, a business unit of Aon plc (NYSE: AON). For more information on Radford, please visit radford.com.

About Aon Hewitt

Aon Hewitt empowers organizations and individuals to secure a better future through innovative talent, retirement and health solutions. We advise, design and execute a wide range of solutions that enable clients to cultivate talent to drive organizational and personal performance and growth, navigate retirement risk while providing new levels of financial security, and redefine health solutions for greater choice, affordability and wellness. Aon Hewitt is the global leader in human resource solutions, with over 35,000 professionals in 90 countries serving more than 20,000 clients worldwide across 100+ solutions. For more information on Aon Hewitt, please visit aonhewitt.com.