

## Fact Sheet: Final Rule to Update the Regulations Defining and Delimiting the Exemption for Executive, Administrative, and Professional Employees

In 2014, President Obama directed the Department of Labor to update and modernize the regulations governing the exemption of executive, administrative, and professional (“EAP”) employees from the minimum wage and overtime pay protections of the Fair Labor Standards Act (“FLSA” or “Act”). The Department published a notice of proposed rulemaking on July 6, 2015, and received more than 270,000 comments. On May 18, 2016, the Department announced that it will publish a Final Rule to update the regulations. The full text of the Final Rule will be available at the Federal Register Site.

Although the FLSA ensures minimum wage and overtime pay protections for most employees covered by the Act, some workers, including bona fide EAP employees, are exempt from those protections. Since 1940, the Department’s regulations have generally required each of three tests to be met for the FLSA’s EAP exemption to apply: (1) the employee must be paid a predetermined and fixed salary that is not subject to reduction because of variations in the quality or quantity of work performed (“salary basis test”); (2) the amount of salary paid must meet a minimum specified amount (“salary level test”); and (3) the employee’s job duties must primarily involve executive, administrative, or professional duties as defined by the regulations (“duties test”). The Department last updated these regulations in 2004, when it set the weekly salary level at \$455 (\$23,660 annually) and made other changes to the regulations, including collapsing the short and long duties tests into a single standard duties test and introducing a new exemption for highly compensated employees.

This Final Rule updates the salary level required for exemption to ensure that the FLSA’s intended overtime protections are fully implemented, and to simplify the identification of overtime-protected employees, thus making the EAP exemption easier for employers and workers to understand and apply. Without intervening action by their employers, it extends the right to overtime pay to an estimated 4.2 million workers who are currently exempt. It also strengthens existing overtime protections for 5.7 million additional white collar salaried workers and 3.2 million salaried blue collar workers whose entitlement to overtime pay will no longer rely on the application of the duties test.

### **\* Key Provisions of the Final Rule \***

The Final Rule focuses primarily on updating the salary and compensation levels needed for EAP workers to be exempt. Specifically, the Final Rule:

1. Sets the standard salary level at the 40th percentile of earnings of full-time salaried workers in the lowest-wage Census Region, currently the South, which is \$913 per week or \$47,476 annually for a full-year worker;
2. Sets the total annual compensation requirement for highly compensated employees (HCE) subject to a minimal duties test to the annual equivalent of the 90th percentile of full-time salaried workers nationally, which is \$134,004; and

3. Establishes a mechanism for automatically updating the salary and compensation levels every three years to maintain the levels at the above percentiles and to ensure that they continue to provide useful and effective tests for exemption.

Additionally, the Final Rule amends the salary basis test to allow employers to use nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10 percent of the new standard salary level. The Final Rule makes no changes to the duties tests.

#### **Effective Date**

The effective date of the Final Rule is December 1, 2016. The initial increases to the standard salary level (from \$455 to \$913 per week) and HCE total annual compensation requirement (from \$100,000 to \$134,004 per year) will be effective on that date. Future automatic updates to those thresholds will occur every three years, beginning on January 1, 2020.

#### **Standard Salary Level**

The Final Rule sets the standard salary level at the 40th percentile of weekly earnings of full-time salaried workers in the lowest-wage Census Region, currently the South (\$913 per week, equivalent to \$47,476 per year for a full-year worker).

The standard salary level set in this Final Rule addresses our conclusion that the salary level set in 2004 was too low given the Department's elimination of the more rigorous long duties test. For many decades the long duties test—which limited the amount of time an exempt employee could spend on nonexempt duties and was paired with a lower salary level—existed in tandem with a short duties test—which did not contain a specific limit on the amount of nonexempt work and was paired with a salary level that was approximately 130 to 180 percent of the long test salary level. In 2004, the long and short duties tests were eliminated and the new standard duties test was created based on the short duties test and was paired with a salary test based on the long test.

The effect of the 2004 Final Rule's pairing of a standard duties test based on the short duties test (for higher paid employees) with a salary test based on the long test (for lower paid employees) was to exempt from overtime many lower paid workers who performed few EAP duties and whose work was otherwise indistinguishable from their overtime-eligible colleagues. This has resulted in the inappropriate classification of employees as EAP exempt who pass the standard duties test but would have failed the long duties test.

The Final Rule's salary level represents the most appropriate line of demarcation between overtime-protected employees and employees who may be EAP exempt and works appropriately with the current duties test, which does not limit non-EAP work.

The Department also is updating the special salary level for employees in American Samoa (to \$767 per week) and the special "base rate" for employees in the motion picture industry (to \$1,397 per week).

#### **HCE Total Annual Compensation Requirement**

The Final Rule sets the HCE total annual compensation level equal to the 90th percentile of earnings of full-time salaried workers nationally (\$134,004 annually). To be exempt as an HCE, an employee must also receive at least the new standard salary amount of \$913 per week on a salary or fee basis and pass a minimal duties test. The HCE annual compensation level set in this Final Rule brings this threshold more in line with the level established in 2004 and will avoid the unintended exemption of large numbers of employees in high-wage areas who are clearly not performing EAP duties.

## **Automatic Updating**

The Final Rule includes a mechanism to automatically update the standard salary level requirement every three years to ensure that it remains a meaningful test for distinguishing between overtime-protected white collar workers and bona fide EAP workers who may not be entitled to overtime pay and to provide predictability and more graduated salary changes for employers. Specifically, the standard salary level will be updated to maintain a threshold equal to the 40th percentile of weekly earnings of full-time salaried workers in the lowest-wage Census Region. Similarly, the Final Rule includes a mechanism for automatically updating the HCE compensation level to maintain the threshold equal to the 90th percentile of annual earnings of full-time salaried workers nationally. The Final Rule will also automatically update the special salary level test for employees in American Samoa and the base rate test for motion picture industry employees. The Department will publish all updated rates in the Federal Register at least 150 days before their effective date, and also post them on the Wage and Hour Division's website.

Regularly updating the salary and compensation levels is the best method to ensure that these tests continue to provide an effective means of distinguishing between overtime-eligible white collar employees and those who may be bona fide EAP employees. Experience has shown that these earning thresholds are only effective measures of exempt status if they are kept up to date.

## **Inclusion of Nondiscretionary Bonuses and Incentive Payments**

For the first time, employers will be able to use nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10 percent of the standard salary level. Such payments may include, for example, nondiscretionary incentive bonuses tied to productivity and profitability. For employers to credit nondiscretionary bonuses and incentive payments toward a portion of the standard salary level test, the Final Rule requires such payments to be paid on a quarterly or more frequent basis and permits the employer to make a "catch-up" payment. The Department recognizes that some businesses pay significantly larger bonuses; where larger bonuses are paid, however, the amount attributable toward the standard salary level is capped at 10 percent of the required salary amount.

The Final Rule continues the requirement that HCEs must receive at least the full standard salary amount each pay period on a salary or fee basis without regard to the payment of nondiscretionary bonuses and incentive payments, and continues to permit nondiscretionary bonuses and incentive payments (including commissions) to count toward the total annual compensation requirement. The Department concludes that permitting employers to use nondiscretionary bonuses and incentive payments to satisfy the standard salary amount for HCEs is not appropriate because employers are already permitted to fulfill almost two-thirds of the total annual compensation requirement with commissions, nondiscretionary bonuses, and other forms of nondiscretionary deferred compensation.

## **Duties Tests**

The Final Rule is not changing any of the existing job duty requirements to qualify for exemption. The Department expects that the standard salary level set in this Final Rule and automatic updating will work effectively with the duties test to distinguish between overtime-eligible workers and those who may be exempt. As a result of the change to the salary level, the number of workers for whom employers must apply the duties test to determine exempt status is reduced, thus simplifying the exemption. Both the standard duties test and the HCE duties test remain unchanged.

**For additional information, visit our Wage and Hour Division Website: [www.wagehour.dol.gov](http://www.wagehour.dol.gov) and/or call our toll-free information and helpline, available 8 a.m. to 5 p.m. in your time zone, 1-866-4-USWAGE (1-866-487-9243).**

This publication is for general information and is not to be considered in the same light as official statements of position contained in the regulations.

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