

AGENCY:

Wage and Hour Division, Department of Labor.

ACTION:

Final rule.

SUMMARY:

The Fair Labor Standards Act (FLSA or Act) guarantees a minimum wage for all hours worked during the workweek and overtime premium pay of not less than one and one-half times the employee's regular rate of pay for hours worked over 40 in a workweek. While these protections extend to most workers, the FLSA does provide a number of exemptions. In this Final Rule, the Department of Labor (Department) revises final regulations under the FLSA implementing the exemption from minimum wage and overtime pay for executive, administrative, professional, outside sales, and computer employees. These exemptions are frequently referred to as the "EAP" or "white collar" exemptions. To be considered exempt under part 541, employees must meet certain minimum requirements related to their primary job duties and, in most instances, must be paid on a salary basis at not less than the minimum amounts specified in the regulations.

In this Final Rule the Department updates the standard salary level and total annual compensation requirements to more effectively distinguish between overtime-eligible white collar employees and those who may be exempt, thereby making the exemption easier for employers and employees to understand and ensuring that the FLSA's intended overtime protections are fully implemented. The Department sets the standard salary level for exempt EAP employees at the 40th percentile of weekly earnings of full-time salaried workers in the lowest-wage Census Region. The Department also permits employers to satisfy up to 10 percent of the standard salary requirement with nondiscretionary bonuses, incentive payments, and commissions, provided these forms of compensation are paid at least quarterly. The Department sets the total annual compensation requirement for an exempt Highly Compensated Employee (HCE) equal to the annualized weekly earnings of the 90th percentile of full-time salaried workers nationally. The Department also adds a provision to the regulations that automatically updates the standard salary level and HCE compensation requirements every three years by maintaining the earnings percentiles set in this Final Rule to prevent these thresholds from becoming outdated. Finally, the Department has not made any changes in this Final Rule to the duties tests for the EAP exemption.

DATES:

This Final Rule is effective on December 1, 2016.

FOR FURTHER INFORMATION CONTACT:

Director, Division of Regulations, Legislation and Interpretation, U.S. Department of Labor, Wage and Hour Division, Room S-3502, 200 Constitution Avenue NW., Washington, DC 20210; telephone: (202) 693-0406 (this is not a toll-free number). Copies of this Final Rule may be obtained in alternative formats (Large Print, Braille, Audio Tape or Disc), upon request, by calling (202) 693-0675 (this is not a toll-free number). TTY/TDD callers may dial toll-free 1-877-889-5627 to obtain information or request materials in alternative formats.

Questions of interpretation and/or enforcement of the agency's regulations may be directed to the nearest Wage and Hour Division (WHD) district office. Locate the nearest office by calling the WHD's toll-free help line at (866) 4US-WAGE ((866) 487-9243) between 8 a.m. and 5 p.m. in your local time zone, or log onto WHD's Web site at <http://www.dol.gov/whd/america2.htm> for a nationwide listing of WHD district and area offices.

. Executive Summary

The Fair Labor Standards Act (FLSA or Act) guarantees a minimum wage for all hours worked and limits to 40 hours per week the number of hours an employee can work without additional compensation. Section 13(a)(1) of the FLSA, which was included in the original Act in 1938, exempts from these minimum wage and overtime pay protections "any employee employed in a bona fide executive, administrative, or professional capacity." The exemption is premised on the belief that these kinds of workers typically earn salaries well above the minimum wage and enjoy other privileges, including above-average fringe benefits, greater job security, and better opportunities for advancement, setting them apart from workers entitled to overtime pay. The statute delegates to the Secretary of Labor the authority to define and delimit the terms of the exemption.

The Department has undertaken this rulemaking in order to revise the regulations so that they effectively distinguish between overtime-eligible white collar employees who Congress intended to be protected by the FLSA's minimum wage and overtime provisions and bona fide EAP employees whom it intended to exempt. When the definition becomes outdated, employees who Congress intended to protect receive neither the higher salaries and above-average benefits expected for EAP employees nor do they receive overtime pay, and employers do not have an efficient means of identifying workers who are, and are not, entitled to the FLSA's protections. With this Final Rule, the Department will ensure that white collar employees who should receive extra pay for overtime hours will do so and that the test for exemption remains up-to-date so future workers will not be denied the protections that Congress intended to afford them.

In 1938, the Department issued the first regulations at [29 CFR part 541](#) defining the scope of the section 13(a)(1) white collar exemption. Since 1940, the regulations implementing the exemption have generally required each of three tests to be met for the 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 (the “salary basis test”); (2) the amount of salary paid must meet a minimum specified amount (the “salary level test”); and (3) the employee's job duties must primarily involve executive, administrative, or professional duties as defined by the regulations (the “duties test”). While payment of a salary does not make an employee ineligible for overtime compensation, the Department has nonetheless long recognized the salary level test is the best single test of exempt status for white collar employees. The salary level test is an objective measure that helps distinguish white collar employees who are entitled to overtime from those who may be bona fide executive, administrative, or professional (EAP) employees. If left at the same amount over time, however, the effectiveness of the salary level test as a means of determining exempt status diminishes as the wages of employees increase and the real value of the salary threshold falls.

The Department has updated the salary level requirements seven times since 1938, most recently in 2004 when the salary level an employee must be paid to come within the standard test for EAP exemption was set at \$455 per week (\$23,660 per year for a full-year worker), which nearly tripled the \$155 per week minimum salary level required for exemption up to that point. The Department also modified the duties tests in 2004, eliminating the “long” and “short” tests that had been part of the regulations since 1949 and replacing them with the “standard” test. The historic long test paired a lower salary requirement with a stringent duties test including a 20 percent cap on the amount of time most exempt employees could spend on nonexempt duties, while the short test paired a higher salary requirement with a less stringent duties test. In other words, prior to the 2004 Final Rule, to exempt lower-paid employees from receiving overtime the employer would have to meet more rigorous requirements; but for higher-paid employees, the requirements to establish the applicability of the exemption were less rigorous. The standard test established by the Department in the 2004 Final Rule paired a duties test closely based on the less-stringent short duties test with a salary level derived from the lower long test salary level. This had the effect of making it easier for employers to both pay employees a lower salary and not pay them overtime for time worked beyond 40 hours. The 2004 Final Rule also created an exemption for highly compensated employees (HCE), which imposes a very minimal duties test but requires that an employee must earn at least \$100,000 in total annual compensation.

On March 13, 2014, President Obama signed a Presidential Memorandum directing the Department to update the regulations defining which white collar workers are protected by the FLSA's minimum wage and overtime standards. [79 FR 18737](#) (Apr. 3, 2014). The memorandum instructed the Department to look for ways to modernize and simplify the regulations while ensuring that the FLSA's intended overtime protections are fully implemented. The Department published a proposal to update the part 541 regulations on July 6, 2015.

One of the Department's primary goals in this rulemaking is updating the standard salary requirement, both in light of the passage of time since 2004, and because the Department has concluded that the effect of the 2004 Final Rule's pairing of a standard duties test based on the less rigorous short duties test with the kind of low salary level previously associated with the more rigorous long duties test was to exempt from overtime many lower paid workers who performed little EAP work and whose work was otherwise indistinguishable from their overtime-eligible colleagues. This has resulted in the inappropriate classification of employees as EAP exempt—that is overtime exempt—who pass the standard duties test but would have failed the

long duties test. As the Department noted in our proposal, the salary level's function in helping to differentiate overtime-eligible employees from employees who may be exempt takes on greater importance when the duties test does not include a specific limit on the amount of nonexempt work that an exempt employee may perform.

In the Notice of Proposed Rulemaking (NPRM), the Department proposed setting the standard salary level at the 40th percentile of weekly earnings of full-time salaried workers nationally and setting the HCE total annual compensation requirement at the annualized value of the 90th percentile of weekly earnings of full-time salaried workers nationally. The Department further proposed to automatically update these levels annually to ensure that they would continue to provide an effective test for exemption. In the NPRM, the Department also asked for the public's comments on whether nondiscretionary bonuses or incentive payments should count toward some portion of the required salary level. Finally, the Department also discussed concerns with the standard duties tests and sought comments on a series of questions regarding possible changes to the tests.

After considering the comments, the Department has made several changes from the proposed rule to the Final Rule. In particular, the Department has modified the standard salary level to more fully account for the lower salaries paid in certain regions. In this Final Rule, the Department sets the standard salary level equal to the 40th percentile of earnings of full-time salaried workers in the lowest-wage Census Region (currently the South). This results in a salary level of \$913 per week, or \$47,476 annually for a full-year worker, based on data from the fourth quarter of 2015.^[1] The Department believes that a standard salary level set at the 40th percentile of full-time salaried employees in the lowest-wage Census Region will accomplish the goal of setting a salary threshold that adequately distinguishes between employees who may meet the duties requirements of the EAP exemption and those who likely do not, without necessitating the reintroduction of a limit on nonexempt work, as existed under the long duties test. The Department sets the HCE total annual compensation level equal to the 90th percentile of earnings of full-time salaried workers nationally (\$134,004 annually based on the fourth quarter of 2015), as we proposed. This increase will bring the annual compensation requirement in line with the level established in 2004. The Department believes that this will avoid the unintended exemption of large numbers of employees in high-wage areas—such as secretaries in New York City or Los Angeles—who are clearly not performing EAP duties.

In order to prevent the salary and compensation levels from becoming outdated, the Department is including in the regulations a mechanism to automatically update the salary and compensation thresholds by maintaining the fixed percentiles of weekly earnings set in this Final Rule. In response to comments, however, the Final Rule provides for updates every three years rather than for annual updates as proposed. The first update will take effect on January 1, 2020. The Department believes that 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. Based on historical wage growth in the South, at the time of the first update on January 1, 2020, the standard salary level is likely to be

approximately \$984 per week (\$51,168 annually for a full-year worker) and the HCE total annual compensation requirement is likely to be approximately \$147,524.

The Department also revises the regulations to permit employers for the first time to count nondiscretionary bonuses, incentives, and commissions toward up to 10 percent of the required salary level for the standard exemption, so long as employers pay those amounts on a quarterly or more frequent basis. Finally, the Department has not made any changes to the duties tests in this Final Rule. The majority of the revisions occur in §§ 541.600, 541.601, 541.602 and new § 541.607; conforming changes were also made in §§ 541.100, 541.200, 541.204, 541.300, 541.400, 541.604, 541.605, and 541.709.

In FY2017,^[2] the Department estimates there will be approximately 159.9 million wage and salary workers in the United States, of whom we estimate that 22.5 million will be exempt EAP workers potentially affected by this Final Rule.^[3] In Year 1, FY2017, the Department estimates that 4.2 million currently exempt workers who earn at least the current weekly salary level of \$455 but less than the 40th earnings percentile in the South (\$913) would, without some intervening action by their employers, become entitled to minimum wage and overtime protection under the FLSA (Table ES1). Similarly, an estimated 65,000 currently exempt workers who earn at least \$100,000 but less than the annualized earnings of the 90th percentile of full-time salaried workers nationally (\$134,004), and who meet the HCE duties test but not the standard duties test, may also become eligible for minimum wage and overtime protection. In Year 10, with triennial automatic updating of the salary and compensation levels, the Department projects that 5.0 million workers will be affected by the change in the standard salary level test and 221,000 workers will be affected by the change in the HCE total annual compensation test.

Additionally, the Department estimates that another 5.7 million white collar workers who are currently overtime eligible because they do not satisfy the EAP duties tests and who currently earn at least \$455 per week but less than \$913 per week will have their overtime protection strengthened in Year 1 because their status as overtime-eligible will be clear based on the salary test alone without the need to examine their duties. Reducing the number of workers for whom employers must apply the duties test to determine exempt status simplifies the application of the exemption and is consistent with the President's directive.

The Department quantified three direct costs to employers in this Final Rule: (1) Regulatory familiarization costs; (2) adjustment costs; and (3) managerial costs. Assuming a 7 percent discount rate, the Department estimates that average annualized direct employer costs will total \$295.1 million per year (Table ES1). In addition to the direct costs, this Final Rule will also transfer income from employers to employees in the form of higher earnings. We estimate average annualized transfers to be \$1,189.1 million. The Department also projects average annualized deadweight loss of \$9.2 million, and notes that the projected deadweight loss is small in comparison to the amount of estimated costs.

The change to a standard salary level based on the lowest-wage Census Region has decreased the salary amount from the proposal, resulting in a smaller number of affected workers and lower transfers than estimated in the NPRM. Direct costs are higher than predicted in the NPRM, primarily because the Department has increased its estimate of the number of affected workers

who work some overtime. Additionally, in response to comments, the Department has increased estimated regulatory familiarization and adjustment costs in the Final Rule.