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## PROPOSED OVERTIME RULE MAY AFFECT EMPLOYEE BENEFIT PLANS

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A recent Department of Labor (DOL) [proposal](#) would increase the salary and compensation levels for workers to be exempt from minimum wage and overtime requirements under the Fair Labor Standards Act (FLSA). DOL estimates about a million people could become eligible for overtime under the revised salary thresholds. Along with assessing the proposal's direct impact on payroll, employers should evaluate the possible indirect impact on some employee benefit plans. Comments on the proposal are due May 21.

### WHITE-COLLAR EXEMPTION FROM MINIMUM WAGE AND OVERTIME PAY

The FLSA requires covered employers to pay a minimum wage to nearly all employees and overtime pay that's at least 150% of an employee's regular rate of pay for any work hours exceeding 40 in a week. The FLSA provides a number of exemptions to these requirements. One minimum wage and overtime exemption, known as the "white-collar exemption," applies to bona fide executive, administrative, professional, outside sales and certain computer employees.

Since 1940, the regulations implementing the white-collar exemption generally have required an exempt employee to satisfy three tests:

- **Duties test.** The employee's job must primarily involve executive, administrative or professional duties
- **Salary basis test.** The employee generally must be paid a predetermined and fixed salary that is not subject to reduction based on the quality or quantity of work performed.
- **Salary level test.** The salary paid must meet a specified minimum weekly level (currently \$455 per week).

In addition, a separate exemption applies to highly compensated employees (HCEs), who are defined differently for this purpose than for nondiscrimination testing. The HCE exemption requires an employee's total compensation (including commissions, nondiscretionary bonuses and certain other nondiscretionary compensation) to meet a much higher threshold — currently \$100,000. In addition, an HCE must meet the salary level test (based on the salary portion of total compensation) and a more relaxed duties test.

In 2016, DOL sought to raise the salary level test to \$913 per week and the HCE compensation test to \$134,004. But a US district court invalidated that rule in 2017, finding the salary level was so high that it effectively eliminated the duties test (*Nevada v. US Dep't of Labor*, No. 4:16-cv-00731-ALM (E.D. Tex. Aug. 31, 2017)).

### **PROPOSAL WOULD RAISE WHITE-COLLAR EXEMPTION THRESHOLDS**

The proposed rule would raise the minimum threshold for the salary level test to \$679 per week. For non-HCEs, nondiscretionary bonuses and incentive payments (including commissions) could satisfy up to 10% of that test, provided the bonuses are paid at least annually. The proposal would also raise the total compensation threshold for the HCE test to \$147,414.

Both the salary level and HCE compensation tests exclude the value of board and lodging, as well as employer payments for medical insurance, life insurance, retirement plans or other fringe benefits. DOL proposes to update the salary level and HCE compensation threshold every four years through a formal regulatory notice and comment process.

### **IMPACT ON RETIREMENT PLANS**

The changes to the overtime rules could affect plan costs and nondiscrimination testing results.

#### **Costs**

If retirement plan sponsors pay more overtime to more employees, both defined benefit (DB) and defined contribution (DC) plans that recognize overtime in their definition of earnings may see increased costs:

- **DB plans.** For a DB plan, the cost increase will depend on the underlying plan formula and the plan's funded status — a 10% increase in affected employees' earnings won't necessarily lead to a 10% increase in pension costs for those employees. For well-funded DB plans, the Internal Revenue Code's funding requirements may mean the immediate cost impact might even be zero.
- **DC plans.** For DC plans that recognize overtime, the effect of more overtime is more easily predicted. A 10% increase in earnings will generally produce a 10% increase in elective deferrals and matching and other employer contributions. However, the exact cost impact will depend on the employee's deferral rate and the plan's contribution formula.

#### **Nondiscrimination Testing**

The proposal is unlikely to substantially change the number of HCEs (as defined for nondiscrimination purposes) and nonhighly compensated employees (NHCEs) since the salary level for overtime exemption is relatively low. (The proposed salary level of \$679 per week equates to \$35,308 per year, whereas the 2019 HCE threshold for retirement plans is \$125,000.) However, a plan's NHCE accrual rates and deferral/contribution percentages may fall if the plan excludes overtime from the pay used to determine benefits but includes overtime in the pay used for nondiscrimination testing. Since HCE accrual rates and deferral/contribution percentages won't be affected — HCEs probably aren't getting overtime now and won't be after the rule change — the overall testing results may suffer.

## IMPACT ON HEALTH AND FRINGE BENEFIT PLANS

The increase in salary thresholds means that some currently exempt employees will be reclassified as nonexempt. Employers should check to see if eligibility for any health or fringe benefits (such as adoption or education assistance, employee discount programs, or group term life insurance) is conditioned on an employee's exempt or nonexempt status. A change in the population of eligible employees for any particular benefit could affect its cost and effectiveness.

## COMPANION PROPOSAL ON EXCLUSIONS FROM REGULAR PAY RATE

A [separate proposal](#) from DOL would clarify the perquisites and benefits that can be excluded from an nonexempt employee's regular pay rate when calculating overtime pay. Comments on that proposal are due May 28.

## RELATED RESOURCES

### Non-Mercer Resources

- [Proposed Regulation on Regular Rate Under the FLSA](#) (Federal Register, March 29, 2019)
- [Proposed FLSA Regulation on White-Collar Exemptions](#) (Federal Register, March 22, 2019)
- [Fact Sheet on Proposed Changes to FLSA White-Collar Exemptions](#) (DOL, March 7, 2019)
- [FAQs on Proposed Overtime Rule](#) (DOL, March 7, 2019)
- [Press Release on Proposed Overtime Rule](#) (DOL, March 7, 2019)
- [Nevada v. US Dep't of Labor](#), No. 4:16-cv-00731-ALM (E.D. Tex. Aug. 31, 2017)

### Mercer Law & Policy Resources

- [DOL Proposes Updates to FLSA Rule on Overtime Calculations](#) (April 9, 2019)

### Other Mercer Resources

- [DOL Overtime Rules Benefits Advice](#) (July 13, 2016)
- [Mercer's Mobility Exchange: Compensation Localizer](#)

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