Insight

Understanding the New Overtime Rule

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The Department of Labor (DOL) has finalized a new overtime rule that changes the salary level requirement for both standard exemptions as well as highly compensated employees (HCE). Under its final regulatory revision, this rule will:

- Raise the threshold of minimum weekly pay that exempts salaried workers from overtime pay from its 2004 level of $455 a week ($23,660 a year) to $684 a week ($35,568 a year).
- Change the salary requirement of highly compensated employees (HCE) to the 80th percentile of earning of the nation's full-time salaried workers ($107,432 per year).

The DOL estimates that this rule will make 1.3 million workers (0.8 percent of the total labor force) newly eligible for overtime pay.

Context

Under the Fair Labor Standards Act (FLSA), employers must give their employees overtime pay for any work beyond the standard 40 hours in a week, and they must pay at a rate 1.5 times higher than regular pay. In order to be exempt from these requirements, workers must meet three criteria, as listed in Section 13(a)(1) of the FLSA: (1) The worker must be salaried; (2) that salary must meet a minimum level; and (3) the duties performed must mainly involve executive, administrative, or professional duties (EAP). These three requirements, known as the salary basis test, the salary level test, and the duties test, respectively, make up the "white collar" or "EAP" exemption. The DOL's new overtime rule would affect only the salary test by raising the minimum threshold.

The Trump Administration's rule effectively rescinds a 2016 Obama Administration proposal, which a federal court had previously invalidated. The Obama Administration sought to raise the standard threshold to $913 a week and the HCE salary requirement to $134,004 a year. The main difference between that proposal and the current rule was that the Obama Administration proposed hiking both salary levels every 3 years, while under the Trump Administration's rule, salary levels would not rise automatically. Under the Obama-era proposal, salary requirements would rise every 3 years to keep the HCE level locked at the 90th percentile of full-time salaried earnings and to keep the standard salary level locked at the 40th percentile of earnings for all full-time salaried workers in the lowest-wage census region.

The Obama rule would have resulted in higher overall regulatory costs because of the automatic threshold increase every 3 years. While the Trump Administration proposal does not include automatic increases, the current DOL has voiced its commitment to update the standard and HCE compensation levels more regularly by using a proposal every 4 years while giving the Secretary of Labor the authority to forestall proposed updates depending on current economic factors.

Impact

Some lawmakers are celebrating this latest overtime rule change, with the expectation that this change would make overtime widely available to all 1.3 million newly eligible workers and help low- and middle-wage earners. Yet the rule may not have quite the impact that many expect.

In a previous iteration of the overtime rule, the DOL had proposed to set the standard salary threshold at its projected January 2020 level in anticipation of future wage growth and have the HCE salary requirement set at the 90^{th} percentile of full-time salaried workers. A previous AAF analysis outlined the costs and impact of this particular change—an analysis that is broadly still applicable to this final version. Only 232,000 of the 1.3 million newly covered workers would regularly benefit from the rule, the authors found, indicating that the new overtime rule may not have the widespread effect that legislators are hoping for due to the number of eligible workers who regularly work more than 40 hours a week.

Some workers certainly will see their earnings rise overall, even if less than hoped, because of this rule. But the workers who are likely to qualify for the overtime benefit because of this rule are at risk of having hours and base wages reduced by their employers.