OVERTIME FINAL RULE

Summary of the Economic Impact Study

In May 2016, the Department of Labor published a final rule that updates the regulations determining which white collar, salaried employees are entitled to the Fair Labor Standards Act's (FLSA) minimum wage and overtime pay protections. As required by the FLSA, the rule delineates which employees receive overtime protection provided by the law from those who are exempt from that requirement. In most cases, for an executive, administrative, or professional (EAP or "white collar") employees to be exempt from overtime, they must pass three tests: 1) the salary basis test, which requires that an employee is being compensated with a salary that does not vary with the quality or quantity of work provided; 2) a salary threshold test, which sets a salary below which workers are overtime eligible and above which they may be exempt; and 3) a duties test, which determines overtime exemption for employees above the salary threshold based on characteristics of the work they do.[1] The latter two tests work closely together to protect overtime-eligible employees and identify exempt employees, with the salary threshold providing a partial proxy for exempt status and the duties test serving as a more specific mechanism for making that determination if a worker earns above the threshold.

The Department updated the salary threshold only once over the last 40 years, so the salary threshold has not been adequately adjusted for changes in the labor market. This erosion of the salary threshold was compounded by changes in the duties test in 2004 that paired a lower salary requirement with a less rigorous version of the duties test that had been historically paired with a higher salary. This pairing meant the salary threshold and duties test weren't working together as intended to screen out only those true EAP employees, resulting in an erosion of overtime protections. Overtime protections for white collar workers thus required updating and modernization. In order to therefore ensure that overtime regulations once again identify workers who should be exempt from overtime protections, the rule adjusts the salary threshold, in keeping with the historic methods of setting it to create a brighter line to separate overtime eligible white collar workers from those that are overtime exempt, while leaving unchanged the duties test.

The rule sets the salary threshold at the 40th percentile of weekly earnings for full-time salaried workers in the lowest wage Census region in the country, currently the South. This means that the rule will increase the salary threshold below which most white collar, salaried workers are entitled to overtime from the current $455 per week (or $23,660 for a full-year worker) to $913 per week (or $47,476 for a full-year worker). Because more workers will fall below a higher threshold, more workers will gain overtime protections. In order to prevent a future erosion of overtime protections and ensure greater predictability, the rule also provides for the automatic updating of the salary threshold every three years based on the standard set out in the 2016 update. The first salary threshold increase will occur on December 1, 2016. More information about the rule, including an overview and links to guidance and technical resources, can be found at **dol.gov/overtime**.

[1] Definitions of these characteristics used in the regulation can be found at this link: **https://www.dol.gov/whd/overtime/fs17a_overview.htm**

As part of the rulemaking process, the Department conducted an extensive, thorough study of the overtime rule's economic impact.

The **economic impact study** is part of the final rule published in the *Federal Register*. The economic impact study is found on *Federal Register* pages 32448-32549. An **earlier version of the economic impact study** was included in the Notice of Proposed Rulemaking, and was open to public comment as part of the rulemaking process at regulations.gov. The Department received more than 270,000 comments on the rule, many of which related to the economic impact study. The Department carefully reviewed these comments in order to develop the economic impact study of the final rule.

What follows is a brief summary of the economic impact study of the final rule.[2] It first covers the three main impacts quantified in the economic impact study of the final rule – the number of workers affected, direct costs to employers, and increased pay for affected workers. It then touches on the many additional topics covered in the economic impact study, and on the effect of the rule on the broader economy.

The number of workers affected

The Department estimates that 4.2 million workers will be *directly affected* by the rule, and 8.9 million currently overtime-eligible workers will get *strengthened* overtime protections. To understand the difference between these two groups, it's useful to keep in mind that to be exempt from overtime protections, white collar workers must pass the three tests described above:

1. They must be paid on a salary basis,
2. They must earn at least the salary threshold, and
3. They must pass the duties test, i.e. they must be employed in a bona fide executive, administrative or professional capacity (EAP).

If a worker fails any of these tests, they are not overtime exempt under the white collar exemption – i.e. in most cases, they are overtime-eligible.

The 4.2 million workers who will be directly affected by the updated regulation are workers who:

1. Are paid on a salary basis,
2. Earn at least $455 but less than $913 per week, and
3. Pass the duties test.

Thus, under the current salary threshold of $455, these workers are exempt from overtime protections. But because they earn less than the new threshold of $913, they are directly affected by the rule. As a result of the new rule, their employers will either have to pay them an overtime-premium when they work more than 40 hours in a week, or give them a raise to the new threshold to maintain their status as overtime-exempt.

The 8.9 million workers who get strengthened protections are workers who:

1. Are paid on a salary basis,
2. Earn at least $455 but less than $913 per week, and
3. ***Fail*** the duties test.

Because they fail the duties test, these workers are actually *currently* entitled to overtime protections. However, because they are paid a salary and earn above the current threshold, their employers must apply the duties test to determine their overtime status. In some cases, their employer may not be appropriately applying the duties test to them and as a result, some of these workers may not be receiving overtime pay when they work more than 40 hours in a week. Because

[2] This summary focuses on the **impacts** of the new standard salary threshold; for a discussion of how the new standard salary threshold was chosen, see pages 32403-32422 and pages 32461-32468.

they earn less than the new threshold, their status as overtime-eligible will be much clearer once the rule is implemented because it will be based solely on their salary level, a purely objective criteria. Thus, these workers will gain strengthened protections as a result of the new rule.

The economic impact study notes that the 8.9 million workers who will get strengthened protections are made up of 3.2 million blue collar salaried workers and 5.7 million white collar salaried workers. The study also estimates that roughly three-quarters of a million (732,000) of the 5.7 million white collar salaried workers who fail the duties test do not currently receive overtime pay when they work more than 40 hours a week. (For details, see pages 32463-32464.) Because of the clarity associated with having a salary below the threshold, the rule will make it much more likely that these workers receive the overtime pay to which they are currently entitled. For the rest, the rule provides extra clarity that when they do work more than 40 hours a week, they should be getting time-and-a-half.

How did DOL determine the number of directly affected workers?

In the economic impact study, the Department analyzed the U.S. workforce through a series of filters to narrow down the universe of workers and estimate the number of workers directly affected by the rule. Using Current Population Survey data from the Bureau of Labor Statistics, the Department began with the universe of all wage and salary workers, and then, in stages, excluded workers who will not be affected by the rule because they are not subject to the FLSA, they are eligible for another exemption, or they are already eligible for overtime pay. These include

(1) workers who are excluded from coverage under the FLSA and the Department's regulations, such as clergy and military personnel,
(2) workers who are covered by another (non-EAP) overtime exemption, such as some agricultural and transportation workers, who are not eligible for overtime regardless of whether they met the requirements for the white collar exemption.
(3) hourly workers (they are already overtime eligible),
(4) salaried workers who are blue collar and therefore not EAP (they are already overtime eligible),
(5) salaried white collar workers who fail the duties test or who earn below the current salary threshold of $455 per week (they are already overtime eligible), and
(6) EAP workers in "named occupations" (including doctors, lawyers, and teachers) who by statute or regulation are overtime-exempt regardless of how much they earn.

This analysis is illustrated in Figure 2 on page 32454. For a detailed description of the groups of workers mentioned here, see pages 32453-32460.

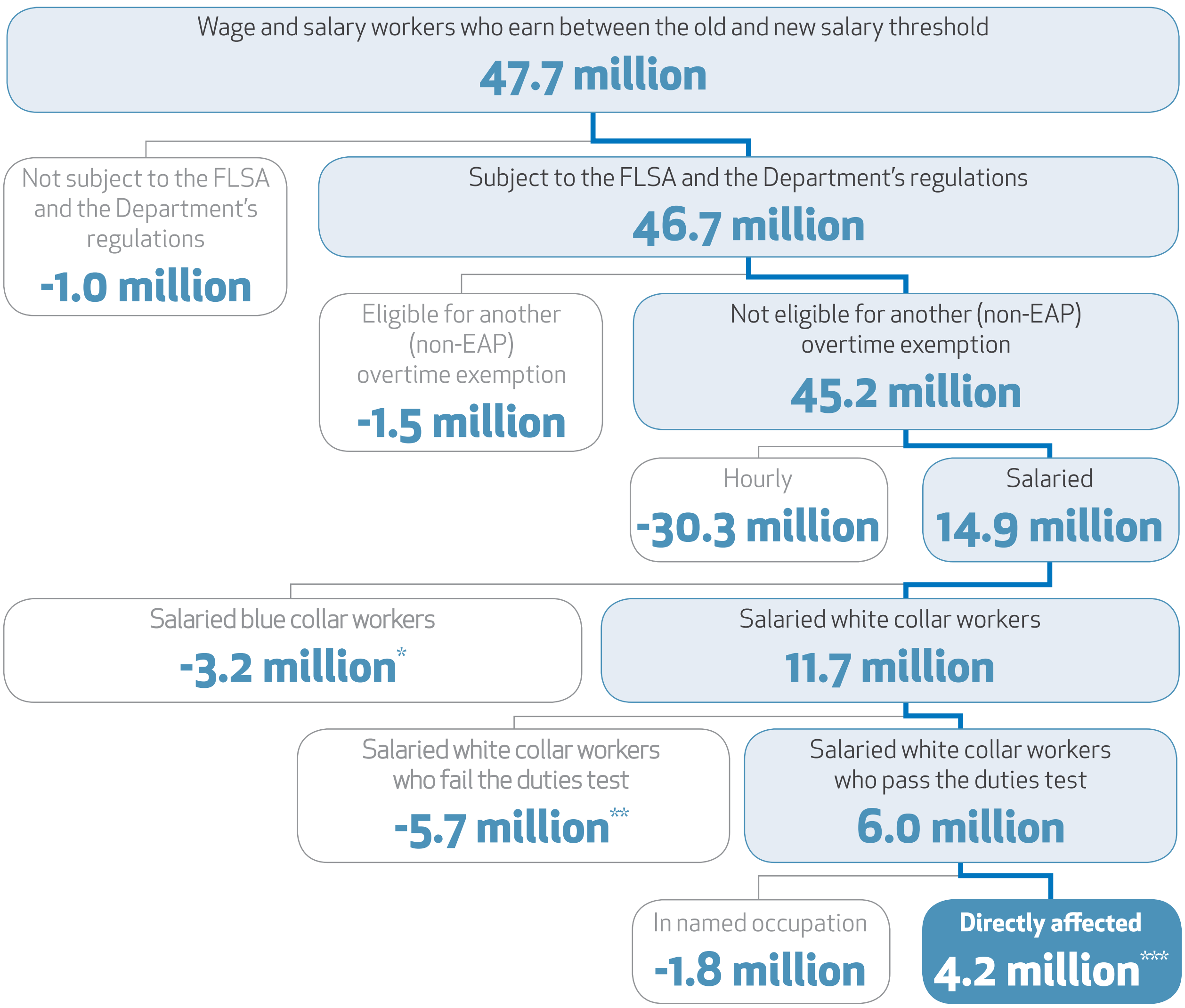
Finally, the department excluded workers who already earn at least the new salary threshold, $913 per week, because they will remain exempt from overtime. This analysis results in **4.2 million** directly affected workers.

How did DOL determine the number of workers with strengthened protections?

The following chart illustrates the process used to estimate the number of salaried workers who will gain strengthened protections – in other words, those whose overtime eligibility will not change (because they are already be overtime-eligible as a result of failing the duties test) but whose entitlement to overtime would be clearer under the rule (because their overtime eligibility will be determined based solely on their salary).

This process starts with the universe of wage and salaried workers who make between $455 and $913 per week (those who fall between the old and the new salary threshold). The first line of the chart shows that there are a total of 47.7 million workers in this group. Each successive stage of the chart removes one of the groups mentioned above. The fourth line of the chart shows that there are 14.9 million salaried workers who earn between $455 and $913 per week who are subject to the FLSA and the Department's regulation and are not eligible for another (non-EAP) overtime exemption. Of these, 3.2 million are salaried blue collar workers who will gain strengthened overtime protections, and 5.7 million are salaried white collar workers who fail the duties test who will also gain strengthened overtime protections.

Note, after excluding all groups who are not *directly* affected by the rule, this methodology reaches the same point as the methodology above and finds that **4.2 million** workers who earn between the old and new salary threshold will be directly affected.



*These are the 3.2 million blue collar salaried workers who will get strengthened protections as a result of the rule.

**These are the 5.7 million white collar salaried workers who fail the duties test who will get strengthened protections as a result of the rule.

***These are the 4.2 million directly affected workers.

Direct Costs to Employers

The economic impact study finds that direct employer costs will average $295 million per year. The study estimates three main direct employer costs.

1. **Regulatory familiarization costs** are the costs to learn about the regulation. This cost will affect all establishments, regardless of whether they have affected workers. Regulatory familiarization costs average **$42 million** per year for the first 10 years, with the vast majority of the costs occurring in the first year, and more modest costs occurring when the salary level is updated every three years. Regulatory familiarization in year 1 is calculated as the median hourly compensation of a human resources specialist multiplied by the assumed average 1 hour that it will take to become familiar with the rule multiplied by the total number of establishments. In years when the threshold is updated, it is assumed that it will take a human resource specialist in every establishment an average of 5 minutes to look up the new threshold (which will be based on publicly available data). See pages 32473-32475 of the final rule for more details on regulatory familiarization costs.[3]
2. **Adjustment costs** are the costs to make decisions about affected workers' new exemption statuses, notify employees of changes, and update payroll systems. Adjustment costs average **$29 million** per year for the first 10 years. Adjustment costs are calculated as the median hourly compensation of a human resources specialist times the assumed average 1.25 hours it takes to make the adjustment per directly affected worker times the number of newly affected workers each year. See pages 32475-32477 of the final rule for more details on adjustment costs.[4]
3. **Managerial costs** are the costs incurred as a result of an increase in the salary threshold because hours may be more closely monitored to accurately account for or minimize paying overtime for workers who are newly overtime eligible, reflecting that employers could respond to the rule in different ways. These costs were not included in the cost-benefit analysis of the 2004 rule, but the Department believes that they are important to quantify. Managerial costs will be incurred for all directly affected workers who either regularly work overtime or occasionally work overtime but on a regular basis. These costs average **$224 million** per year for the first 10 years. Managerial costs are calculated based on the median compensation of a manager multiplied by the assumed average 5 minutes per week for the additional monitoring (i.e. more than one hour per quarter) multiplied by the total number of directly affected workers who work overtime either regularly or occasionally but on a regular basis. See pages 32477-32478 of the final rule for more details on managerial costs.

Increased Pay for Employees

The economic impact study finds that the rule will result in an average annual increase in pay to workers of $1.2 billion per year. This increase in pay is referred to as a ***transfer*** from employers to employees and is based on a careful review of published, peer reviewed studies, as explained below. This section of this summary is a distillation of pages 32481-32493 of the economic impact study, which describes the methodology and results in detail.[5]

To estimate the increased pay, careful consideration was given to how employers are likely to respond to the rule. The rule does not dictate or recommend any method of compliance

[3] The additional regulatory familiarization costs in years when the threshold is updated were not included in the economic impact study in the NPRM, but were added in response to public comments.

[4] In the economic impact study in the NPRM, it was assumed that it would take a human resources specialist one hour per affected worker to make the necessary adjustments. That figure was increased to 1.25 hours per affected worker in response to public comments.

[5] For simplicity, because the effects are small, this summary does not focus on transfers that occur as a result of more workers being eligible for the minimum wage; see pages 32482-32485 for more details on transfers due to the minimum wage. For the same reason, this summary also does not focus on transfers that occur as a result of the increase in the HCE compensation threshold. These transfers are discussed throughout the transfer section of the economic impact study, pages 32481-32493.

with the change in salary level. Importantly, how employers respond to a particular affected worker will depend on what that worker currently earns and how many overtime hours he or she works. The economic impact study finds that about 20 percent of affected workers regularly work overtime and another 19 percent occasionally work overtime.[6] For the roughly 60 percent of affected workers — 2.6 million workers — who do not work any overtime, it is assumed that they will receive no increase in pay. These workers are referred to as "Type 1" workers in the economic impact study (see Table 19 on page 32490). Despite the fact that they don't typically work overtime and will not receive an increase in pay, these Type 1 workers still receive an important assurance that they will be overtime-protected should they ever need to work more than 40 hours in a week.

The 1.7 million affected workers who work overtime either regularly or occasionally are the workers who will likely see an increase in pay and/or an adjustment in the hours they normally work. Employers will likely respond to the rule in a variety of ways with respect to these workers. For workers who currently earn close to the threshold and work a lot of overtime, an employer may give them a raise to the new threshold to maintain their overtime-exempt status. In the economic impact study, it is estimated that 96,000 affected workers will get a raise to the new threshold. These workers are referred to as "Type 4" workers (see Table 19 on page 32490).

For workers who earn substantially less than the new threshold or who don't work a lot of overtime, an employer will likely not give them a raise to the new threshold, which means they would be newly eligible for overtime pay if they work more than 40 hours in a week. It is estimated in the economic impact study that 817,000 affected workers who *occasionally* work overtime will be newly overtime-eligible. These workers are referred to as "Type 2" workers. It is estimated that 759,000 affected workers who *regularly* work overtime will be newly overtime eligible; these workers are referred to as "Type 3" workers. (See Table 19 on page 32490.)

An employer may downwardly adjust the base pay of a newly overtime-eligible worker who works overtime (i.e. Type 2 and Type 3 workers) to offset some of the new overtime costs. They also may reduce the overtime hours these newly overtime-eligible workers work, given that the marginal cost for an overtime hour worked by these workers will have increased from zero to time-and-a-half. In the economic impact study, assumptions regarding the net effect of the possible employer responses to affected workers who work overtime are based on the empirical academic literature on how businesses respond to overtime pay regulations. An adjustment model was developed based on this literature. The model predicts that affected workers who work overtime will, on average, see a modest decline in base pay and a decline in overtime hours, but will see an overall *increase* in weekly wages because they will earn time-and-a-half on the overtime hours that they do work.[7] This net adjustment reflects that while some employers will seek to moderate the cost impacts of the rule, they also desire to not lose the valued employees impacted by the rule, given that they are often key staff entrusted with responsibilities like closing up stores, overseeing expensive capital equipment, and making critical decisions.

[6] In the economic impact study in the NPRM, the Department estimated, based on monthly CPS data, that approximately 25 percent of affected workers worked overtime either regularly or occasionally and 75 percent of affected workers did not work any overtime. In the Final Rule the Department looked at supplemental data from the Survey of Income and Program Participation (SIPP) that estimated the likelihood of employees working some overtime during the year and increased the estimate of affected workers who work overtime occasionally or regularly to match the overall share of workers who report working overtime at some point in a year.

[7] Note, the department assumes that workers who the model implies will earn at least the new overtime threshold (minus the managerial costs associated with more closely monitoring newly overtime eligible workers) will be given a raise to the new threshold and remain overtime-exempt (these are the Type 4 workers).

Thus, newly overtime eligible workers who currently work overtime will, on average, work fewer hours and earn more as a result of the rule. For workers who are newly overtime eligible and who work regular overtime, weekly earnings are expected to rise on average by roughly 3 percent (2.8 percent). The average increase in weekly earnings for all 4.2 million affected workers — even including the nearly 60 percent who do not work any overtime and therefore are not expected to see an increase in earnings — is roughly 1 percent (0.7 percent). The average increase in weekly pay across all affected workers times the number of affected workers times 52 weeks is what yields the $1.2 billion in total increased pay to affected workers. (See Table 22 on page 32492.)

Additional topics in the economic impact study

The economic impact study covers a variety of additional costs, transfers, and benefits — some of which are quantified and some of which are discussed qualitatively due to data limitations. The additional impacts addressed include reduced litigation due to the greater clarity provided by the new threshold for millions of workers, improved work-life balance for those affected workers who work fewer hours, increases in hiring costs if new workers are hired to cover overtime hours of newly overtime-eligible workers, potential effects on fringe benefits, and deadweight loss. Discussion of these and many other additional costs, transfers, and benefits can be found on pages 32478-32481, 32493-32494, and 32498-32504 of the final rule.

The study also includes an analysis of the impact of the rule by region and industry on pages 32495-32498. For example, a breakdown of the number of workers affected in the non-profit sector can be found in Table 14 on page 32472. The study also provides a detailed analysis of the impact on small employers on pages 32525-32545, and of the impact on state and local governments on pages 32545-32549.

The study includes a detailed analysis addressing the possibility that because the salary level is automatically updated every three years to the 40th percentile of earnings of full-time salaried workers in the lowest wage Census region, the threshold may “ratchet” up if affected workers are converted to hourly pay and thus excluded from future calculations of the threshold. This analysis can be found on pages 32506-32508. It shows that historically, employers have not converted significant numbers of workers to hourly pay when federal and state overtime salary levels have been updated in the past. It also shows that even ***if*** conversion to hourly pay were to occur, the potential “ratcheting” effect would be minimal (resulting in a salary threshold just 2.5 percent higher than expected in 2026, after three updates) because newly nonexempt workers who work overtime hours compose a small percentage of all full-time salaried workers below the new threshold.

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Why won't this rule disrupt the economy?

The $1.2 billion in increased pay to employees and the $295 million in average annual direct costs to businesses will together result in roughly $1.5 billion dollars per year in increased payroll costs for businesses. But that's ***well under one-tenth of one percent*** **of total U.S. payroll costs**, which in the aggregate are more than $6.5 trillion. (See pages 32496-32498 for details.) While the rule will have a meaningful effect for workers who see higher pay, work fewer hours, and/or gain clarity about their status as overtime-eligible, it will not have a disruptive effect on the broader economy.

Modernizing the white collar overtime regulations will reverse the erosion of overtime protections that has occurred over several decades (see Figure 1 on page 32450). By providing for a method of automatic updating, the rule will prevent a future erosion of these protections, and make it easier for both employers and workers to clearly understand where they stand in regard to overtime coverage. By clarifying these protections for millions of workers, the rule will also lead to better use of the most precious resource — people's time — by providing a renewed incentive for employers to balance the additional hours they ask of these employees with the costs of overtime pay. The final rule is consistent with the fundamental principle embodied in the Fair Labor Standards Act of receiving a fair day's pay for a long day's work. ■