NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS

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CHANGES IN THE FAIR LABOR STANDARDS ACT

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FLSA General Overview – Insurance Industry

In general, the Fair Labor Standards Act ("FLSA" or the "Act") requires employers to pay employees one and one-half times their regular hourly-rate when they work overtime (more than 40 hours in a week). Some employees, however, are exempt from this general rule (i.e., overtime ineligible) and do not need to be paid extra for overtime hours worked.

This memorandum analyzes the Department of Labor's ("DOL" or "Department") final rule, issued on May 23, 2016, that is likely to reduce dramatically the number of employees who will be exempt from overtime pay requirements. The rule doubled the minimum salary threshold required to qualify for the Act's "white collar" exemptions to $47,476 per year ($913 per week), substantially greater than the yearly salary of $23,660 per year ($455 per week) contained in current regulations. The new salary threshold will go into effect on December 1, 2016 and would then be updated automatically every three years beginning on January 1, 2020. DOL expects the final rule to reduce the number of employees exempt from overtime pay requirements by nearly 4.2 million people within the first year of its implementation.

These revised overtime regulations will have a significant impact on businesses of all shapes and sizes, including the insurance industry. For example, even though the Department will now allow a portion of earned commissions to be applied to the overtime eligibility salary threshold, an individual's base salary before commission must still be at least 90 percent of the threshold. Employees who satisfy the "outside sales" personnel requirements may be excluded from this entire regime (so no overtime need be paid). To the extent a firm has treated sales personnel as "independent contractors," the Department's separate independent contractor Guidance issued in July 2015 may effectively bar many commissioned sales personnel – including most insurance producers – from being treated as independent contractors going forward. Producers thus generally will have to be paid a minimum base salary of almost $43,000 unless the "outside sales personnel" requirements are satisfied to avoid overtime pay requirements.

Employers should reevaluate their existing employment relationships with special attention to existing and potential overtime obligations based on the final rule. Once the rule goes into effect, it is highly likely that the Department – and zealous plaintiffs' attorneys – will be vigilantly monitoring and litigating potential overtime misclassifications and business non-compliance.

Background on the Fair Labor Standards Act and Overtime Regulations

In 1938, the FLSA put in place the nation's first overtime protections, which require workers be compensated time-and-a-half for any hours worked over 40 hours in a week. The so-called overtime exemption, which applies to specific types of businesses and/or specific types of work, was premised on the notion that exempted employees – i.e. employees ineligible to receive overtime – typically were compensated substantially above the minimum wage and enjoyed other privileges, such as above-average fringe benefits, to reward them for their long hours of

work. Generally, all hourly employees are guaranteed overtime. Salaried employees, in contrast, receive the same guarantee unless the employee:

(1) is paid an amount higher than the salary threshold set by DOL, and

(2) passes one of three "duties tests" which require that the employee's duties primarily involve executive, administrative and/or professional tasks.

In other words, salaried white collar workers generally are entitled to overtime compensation if they are paid below the overtime salary threshold. If the employee is compensated at or above the salary threshold, s/he may be exempt from overtime pay provided s/he primarily performs certain executive, administrative and/or managerial duties. Doctors, lawyers, and teachers, along with a select number of other occupations, are not required to be eligible for overtime pay or are governed by special provisions.

Overview of Final Overtime Rule

Today, to qualify for the "white collar" exemption employees must meet the job-related duties related test and be paid at least $455 per week – or $23,660 per year. DOL's final rule increases that salary threshold, which was last updated in 2004, bringing it to $47,476 per year ($913 per week), the 40th percentile of full-time salaried workers in the lowest income Census region (currently, the American South). This number is slightly lower than the number initially proposed by the Department ($50,440 per year, $970 per week), which was based on the 40th percentile of weekly earnings for full-time, salaried workers nationwide. In addition, for the first time since enactment of the FLSA, the Department will allow up to 10 percent of the salary threshold to be met with nondiscretionary bonuses, incentive payments, or commissions that are paid quarterly or more frequently. In other words, to avoid the overtime pay obligations, an individual's base salary before commission must still be at least 90 percent of the threshold – approximately $43,000 – but an employer could count $4,747 of nondiscretionary bonuses or commissions towards the individual's salary.

DOL is also instituting an "automatic update" for the salary threshold. Beginning in 2020, the salary level will be increased automatically every three years. Every update will automatically increase the threshold to the 40th percentile of full-time salaried workers in the region in which the salary level is lowest (historically, the South). All new salary levels will be posted in the Federal Register 150 days before their effective date, beginning on August 1, 2019. The first automatic update is expected on January 1, 2020—and it is estimated that the salary threshold would be raised to $984 per week ($51,168 annually for a full-year worker).

Lastly, the final rule did not change the current job-duties-related tests. For salaried workers earning more than the threshold, the duties test determines whether or not they can still be eligible for overtime compensation.

Analysis

I. Overview of Current Law

A. Determining Overtime Eligibility – An Overview

To determine whether an employee is exempt (ineligible) from receiving overtime, an employee must meet two tests. First, the employee must meet the "salary test," meaning s/he 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 employee's compensation must meet a minimum specified amount. Second, the employee's job duties must meet the "duties test," meaning they must primarily involve executive, administrative, or professional duties as defined under the regulations.

Since 1938, the Department has updated the salary level requirements seven times, most recently in 2004. From 1949 until 2004, there were two different "duties tests" for executive, administrative, and professional ("EAP") employees, which varied according to the employee's salary level, and were designed to ensure that overtime-eligible employees were not swept into the exemption by mistake. In 2004, DOL replaced the two duties tests with a single standard test that did not include a cap on the amount of nonexempt work that could be performed.

B. Determining Overtime Eligibility – Salary Threshold and Duties Test

Currently, the regulations delineate specific criteria that define each category of exemption provided under FLSA for bona fide EAP employees. The burden of establishing whether any FLSA exemption applies to a particular employee falls on the employer. Mere job titles and descriptions are not sufficient to determine exempt status, nor is paying an employee a fixed (non-hourly) salary adequate to establish that an employee is not eligible for overtime. Rather, to qualify for a white collar exemption, an employee must meet the job duties and salary tests. Since DOL's last rulemaking in 2004, for an employee to be ineligible for overtime, s/he usually had to have been paid on a salary basis of not less than $455 per week, approximately $23,660 per year for a full-time worker.

To meet the requirements of an overtime exemption under the FLSA, employees must be compensated at the rate described above and meet the duties test for the applicable exemption. Therefore, employers must evaluate whether an employee's primary job duties fall into one of the below exemptions (e.g., supervising employees, overseeing business operations, providing individualized advice and recommendations to clients relating to insurance and financial products, etc.). DOL has indicated that the employee must perform this work 50 percent or more of his working time. An:

• Executive employee must have a primary duty of managing the enterprise or a department or subdivision of the enterprise. Moreover, the exempt executive employee must "customarily and regularly" direct the work of at least two employees and have the ability to hire or fire them; or

that employee's suggestions and/or recommendations vis-à- vis the hiring, firing, or change in status of the other employees must be given particular weight.

• Administrative employee must primarily perform office or non-manual work directly related to the management or general business operations of the employer or the employer's customers. The employee's primary duty must also involve the "exercise of discretion and independent judgment with respect to matters of significance."

  o Under the regulations, for example, "insurance claims adjusters generally meet the duties requirements for the administrative exemption, whether they work for an insurance company or other type of company, if their duties include activities such as interviewing insureds, witnesses and physicians; inspecting property damage; reviewing factual information to prepare damage estimates; evaluating and making recommendations regarding coverage of claims; determining liability and total value of a claim; negotiating settlements; and making recommendations regarding litigation."

• Professional employee must have a primary duty of (1) work requiring advanced knowledge in a field of science or learning that is usually achieved by a "prolonged, course of specialized intellectual instruction" or (2) work requiring originality, invention, imagination, or talent in a recognized field of artistic or creative endeavor. Generally, professional employees perform work "requiring the consistent exercise of discretion and judgment, as distinguished from the performance of routine mental, manual, mechanical or physical work."

The EAP exemptions listed above provide the traditional duties exemptions for "white collar" employees. However, there are also exemptions for outside sales and computer employees. An:

- Outside Sales employee must primarily make sales or obtain orders or contracts for services for which a consideration will be paid by the client or customer. The employee must also be customarily and regularly engaged away from the employer's place of business.

- Computer employee must be "skilled in the computer field" and is generally exempt from overtime if, in performing his duties, applies systems analysis techniques to determine hardware, software, or system functional specifications or otherwise designs, develops, or modifies computer systems and programs. An employee could also be exempt if his primary duty involves "planning, scheduling, and coordinating activities" necessary to develop systems to solve complex business problems for the employer.

Employees who meet the requirements set forth above, while also meeting the salary test, are excluded from the Act's minimum wage and overtime pay protections. Such employees are thus permitted to work any number of hours in the workweek beyond the traditional 40 hours and are not subject to the overtime pay requirements under the FLSA. Nevertheless, despite the standards set by the FLSA, the Act does not preempt state standards that may be stricter than the federal standards.

II. The Final Rule

In March 2014, President Obama directed the Department to modernize and simplify the overtime regulations while ensuring that FLSA's overtime protections remain strong. On July 6, 2015, the U.S. Department of Labor published a proposed rule to update and revise regulations implementing overtime pay exemptions. In that proposal, the Department proposed to:

(A) change the salary level that triggers the overtime exemption and

(B) institute a mechanism for automatically updating the standard salary threshold.

DOL also requested comments on whether or not it should alter the current duties test. The final rule was published in the Federal Register on May 23, 2016.

A. The Final Rule will double the overtime salary threshold and incorporate nondiscretionary bonuses into the salary threshold.

DOL's final rule increases the salary threshold to $47,476 per year ($913 per week), the 40th percentile of full-time salaried workers in the lowest income Census region (currently, the American South). This number is slightly lower than the number initially proposed by the Department ($50,440 per year, $970 per week), which was based on the 40 percentile of weekly earnings for full-time, salaried workers nationwide. As proposed, the final rule also raises the highly compensated employee salary threshold to the 90th percentile of weekly earnings for full- time salaried employees nationally, which will amount to $134,004 when the rule goes into effect.

In addition, for the first time since enactment of the FLSA, the Department will allow up to 10 percent of the overtime salary threshold to be met with nondiscretionary bonuses, incentive payments, or commissions – payments that are generally "announced to employees to encourage them to work more steadily, rapidly or efficiently, and bonuses designed to encourage employees to remain with a facility" – that are paid quarterly or more frequently. In other words, an individual's base salary before commission must still be at least 90 percent of the threshold – approximately $43,000 – but an employer could count $4,747 of nondiscretionary bonuses or commissions towards the individual's salary. These payments must, however, be incorporated into the individual's salary quarterly or more frequently to be eligible for this treatment. If an employer fails to incorporate such nondiscretionary bonus, incentive, and commission payments by the end of the quarter, s/he is allowed to make one "catch-up" payment "no later than the next pay period after the end of the quarter," which will count only toward the prior quarter's salary amount. Although such payments may not be used to satisfy the salary threshold test if they are made only on an annual or semi-annual basis – a typical practice from many companies – they do represent an important and valuable change to existing overtime regulations benefitting both employers and employees.

DOL supports its decision to count nondiscretionary bonus, incentive, and commission payments towards 10 percent of the salary threshold because it recognizes the "increased role bonuses play in many compensation systems." Notably, however, DOL ultimately permitted such payments to be included quarterly, rather than weekly, in response to arguments that weekly inclusion would present significant administrative burdens on businesses.

B. The Final Rule established a triennial automatic update mechanism based on a fixed percentile of wages.

Due to the long periods of time between rulemakings, which have resulted in salary levels that are based on outdated salary data and distorted overtime determinations, the Department has established a mechanism for automatically updating the standard salary test, as well as the total annual compensation requirement for highly compensated employees ("HCE"). Beginning in 2020, the salary level will be increased automatically every three years. Every update will automatically increase the threshold to the 40th percentile of full-time salaried workers in the region in which the salary level is lowest (historically, the South). More specifically, the threshold will be updated to "equal the 40th percentile of weekly earnings of full- time non-hourly workers in the lowest-wage Census Region in the second quarter of the year preceding the update as published by the Bureau of Labor Statistics." All new salary levels will be posted in the Federal Register 150 days before their effective date, beginning on August 1, 2019. The first automatic update is expected on January 1, 2020—and it is estimated that the salary threshold would be raised to $984 per week ($51,168 annually for a full-year worker).

Although DOL ultimately included an automatic update to the salary threshold to ensure that the threshold does not become obsolete and ineffective, the Department did lengthen the update cycle to address concerns that annual updates would place significant administrative burdens on small businesses in particular. As mentioned above, the final rule provides for updates every three years rather than for annual updates as proposed. It also requires the publication of such updates at least 150 days before they take effect, instead of just 60 days, which is what DOL proposed.

C. Insurance Agents

With the new changes to FLSA, questions have come up with regards to Agents and/or Producers. Brokers want to know are there any changes for this group of employees.

Agents generally enter into commission arrangements with insurance companies that govern their compensation and they are paid primarily or entirely through commissions on the insurance products they sell to clients. The commissions typically represent a portion of the first year premiums, renewal premiums, and other monies paid to the company by the insurance agent's clients.

Section 13(a)(1) of the FLSA provides an exemption from the statute's minimum wage and overtime requirements for "any employee employed . . . in the capacity of outside salesman." The Department's regulations define that phrase as including "any employee":

(1) Whose primary duty is:
(i) making sales within the meaning of section 3(k) of the Act, or
(ii) obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer; and

(2) Who is customarily and regularly engaged away from the employer's place or places of business in performing such primary duty.

Under 29 C.F.R. § 541.500. "Primary duty" means "the principal, main, major, or most important duty that the employee performs." 29 C.F.R. § 541.700. Section 3(k) of the FLSA defines "sale" as "any sale, exchange, contract to sell, consignment for sale, shipment for sale, or other disposition." See also 29 C.F.R. § 541.501.

Under 29 C.F.R. § 541.701, "the phrase 'customarily and regularly' means a frequency that must be greater than occasional but which, of course, may be less than constant. Tasks or work performed 'customarily and regularly' includes work normally and recurrently performed every workweek; it does not include isolated or one-time tasks."

The regulations provide further guidance regarding what it means to be "engaged away from the employer's place of business" for purposes of 29 C.F.R. § 541.500. "The outside sales employee is an employee who makes sales at the customer's place of business or, if selling door-to-door, at the customer's home. Outside sales does not include sales made by mail, telephone or the Internet unless such contact is used merely as an adjunct to personal calls." 29 C.F.R. § 541.502.

Outside sales employees may perform promotional work as an exempt outside sales activity if it "is actually performed incidental to and in conjunction with an employee's own outside sales or solicitations." 29 C.F.R. § 541.503. Whether promotional work is to be considered exempt is determined on a case-by-case basis.

The typical duties of an agent include:

- The agents sell insurance policies and financial products and services directly to clients, and spend a majority of their time performing tasks directly related to their own sales activities.

- The agents customarily and regularly meet with clients face to face outside of their offices (e.g., at a client's home or business or at a restaurant or club) to sell insurance policies and financial products.

- The agents communicate with clients by telephone, direct mail, and e-mail as an adjunct to their in-person sales calls, and these communications occur both outside of and within their offices. They also spend time in the office preparing for meetings with current or prospective clients; communicating with clients by telephone, e-mail and letter correspondence; answering clients' questions; preparing and reviewing documents and forms required to sell insurance products; following up on applications; educating themselves about various insurance or financial products; compiling and updating client lists or databases; creating marketing or promotional activities in support of their own sales activities; attending training on the company's products; and attending compliance meetings addressing regulatory issues. In addition to direct selling efforts, agents also conduct research to select the specific types and amounts of insurance products to recommend and sell to clients to best meet the client's needs. You state that the in-office activities are incidental to or in conjunction with the insurance agent's own outside sales activities.

- The agents are responsible for originating their own sales and developing their own client lists by contacting or networking with current or prospective clients and by developing and maintaining relationships with sources of leads and referrals. They make in-person calls on or attend social functions with real estate agents, attorneys, brokers, and other potential sources of referrals and leads. Insurance agents also make presentations at seminars or gatherings of trade associations and civic and non-profit organizations. For instance, the agents may participate in seminars or conferences to explain new products they sell and to identify and attract new clients. You state that these marketing and prospecting activities are incidental to and in conjunction with each insurance agent's own outside sales activities to obtain additional clients and make additional sales.

Finally, the agents may qualify for the outside sales exemption even though they perform some activities at their employers' place of business, so long as the inside sales activity is incidental to and in conjunction with qualifying outside sales activity. See 69 Fed. Reg. 22,160, 22,163 (Apr. 23, 2004) (copy enclosed); 29 C.F.R. §§ 541.500(b); Olivo v. GMAC Mortgage Co., 374 F. Supp. 2d 545, 551 (E.D. Mich. 2004). The performance of activities related to the sales of insurance and financial products made outside the employer's place of business does not disqualify the agents from the exemption. Activities such as making phone calls, sending e-mails, and meeting with clients in the office are considered exempt if performed incidental to or in conjunction with the agent's outside sales activities. 29 C.F.R. § 541.503; FOH § 22e02; Opinion Letter FLSA2006-11 (Mar. 31, 2006).

Therefore, per DOL Opinion Letter FLSA 2009-28, although each agent must be evaluated on an individual basis to determine whether he or she qualifies for the outside sales exemption, those employees whose job duties match the duties described above would be exempt from the minimum wage and overtime requirements of the FLSA.

The salary basis test is inapplicable to outside sales employees. 29 C.F.R. § 541.500(c).

D. The Final Rule made no changes to the duties test.

DOL also sought comment on whether it should adjust the duties test in light of the proposed change in the salary level. According to DOL, the duties test has always functioned in tandem with the salary requirements to determine whether an employee qualifies as exempt from overtime. Succinctly, the salary test is the "bright-line test" for a white collar exemption, the duties test comes into play afterwards to ensure that overtime-eligible employees are not erroneously identified as overtime exempt. To meet the duties test – and be determined overtime ineligible – an employee's work must primarily involve executive, administrative, or professional duties as defined under the regulations.

According to the Department, the final rule contains no changes to the duties test because DOL recognized that it is "more difficult for employers and employees to both understand and implement" a duties test compared to a bright-line salary threshold. DOL also supported its decision not to change the duties test because it "believes that the standard salary level adopted in this final rule coupled with automatic updating in the future will adequately address" the Department's concern that employees in lower-level management positions are incorrectly classified as exempt under the existing duties test and "thus ineligible for overtime pay even though they are spending a significant amount of their work time performing nonexempt work." While such reasoning should not be discounted, it is also possible that DOL – despite assertions to the contrary – avoided altering the duties test because many commentators, argued that by not proposing specific changes to the duties test in its proposed rule, DOL lacked the legal authority to enact changes in the final rule.

III. Recommendations

A. What PIA Members Should Consider

The Department's final rule has far-reaching implications for the insurance industry both in terms of the direct financial impact on business and the indirect risks to business in light of DOL's Guidance on Independent Contractors. Employers should review their employee classifications to determine how they will respond to the changes in the overtime salary threshold. Before December 1, 2016, employers should review and analyze the status of all employees, particularly those who earn below, at, or slightly above the overtime threshold ($47,476 per year, $913 per week). Companies must remember that if an individual's job does not involve the performance of primarily executive, administrative, managerial and/or the required duties under other exemptions, the employee may still be eligible for overtime pay even if s/he is paid on a salary basis at or above the overtime threshold. Employers should not assume that an employee is in a managerial or "white collar" role based on their title. Rather, companies must evaluate and document employees' job duties and the amount of time spent on exempt duties to determine whether they qualify for an overtime exemption.

Once employers have a general understanding of the impact of the final rule on their current salary and employment structure, businesses should perform a "cost-benefit analysis" to

determine the most appropriate response to the new threshold. For any employee whose overtime exempt status is ambiguous, employers should decide whether that worker should be overtime eligible (non-exempt) or overtime ineligible (exempt) and ensure that the individual's salary and job duties are adjusted accordingly. Depending on the results of such an analysis, employers can choose to:

(1) Raise the salaries of certain employees to maintain their overtime exemption status.

In order to ensure that "white collar" employees whose duties primarily involve the performance of executive, administrative and/or managerial tasks, continue to remain ineligible to receive overtime, employers may need to raise their salaries to or above the new threshold ($47,476).

(2) Retain current compensation levels and pay overtime for all hours worked over 40 in a given week.

Employers will need to carefully determine how many hours employees are actually working to determine whether taking this approach is the most cost-effective for their business or whether they should limit the overtime hours overtime eligible employees work (option 3) or reclassify the workers (option 1).

(3) Reorganize workloads, adjust employee schedules, or otherwise distribute work hours amongst employees to minimize the amount of overtime that will be paid in a given week.

If an employer determines that it is necessary to limit employees' overtime hours to keep business costs low, s/he must vigilantly manage and monitor schedules to ensure that employees are not working extra hours (remotely or in-store). This holds true even if an employee wishes to work extra hours of his or her own volition.

(4) Adjust wages in other ways (e.g., adjust nondiscretionary bonuses etc.).

This option goes in tandem with option 1. Employers may choose to adjust wages to maintain an employee's overtime exempt status via adjustment of nondiscretionary bonuses or incentive payments.

Any route employers take will involve costs. In addition to the administrative costs of conducting a simple review of current employee classifications, the time and effort it will take to adjust work schedules and wages to come into compliance with the final rule will be significant. There may also be a negative impact on business productivity, as the rule would impact whether or not an employee can perform work on nights, weekends, or remotely. For example, companies may need to restrict employees who previously were exempt but are now reclassified as overtime eligible from using smartphones, laptops, or other devices because it is difficult to track work performed outside of the office on those devices and such work could result in overtime for these employees. Similarly, companies may witness a decrease in morale

as employees, who were previously paid on an annual basis, are converted to hourly employees. Such employees will likely be managed more closely, will be required to record their working time, and may lose some of the flexibility in their working hours they currently enjoy, which allows them to take more leisurely lunches or leave work to watch a child's school play.

B. Liability Concerns

For all of the above reasons, it will be critical for management and human resource departments to coordinate the transition to minimize workplace disruptions and noncompliance. The Department has indicated it will be actively enforcing against noncompliance. Thus, employers should manage the transition carefully to avoid potential employee and former employee claims that would instigate agency investigations. Generally, if DOL investigates an overtime complaint against an employer, the resulting settlement to resolve the complaint would involve, at minimum, paying double the amount of overtime owed to the employee. Nevertheless, DOL might not be the biggest concern. Plaintiffs' attorneys are now scrutinizing the new regulations as they look for new opportunities to represent workers in cases suing their employers for labor violations. Thus, beyond reclassifying workers and/or adjusting salaries, it is very important that employers educate managers and employees about new overtime policies and communicate expectations regarding working time, overtime and timekeeping. In this vein, employers must then be careful to enforce those policies and should ensure that timekeeping records are accurate and maintained appropriately.

Finally, businesses should also keep in mind that the Department also is actively enforcing against the misclassification of employees as independent contractors. Shortly after issuing the overtime proposed rule, DOL published a Guidance to prevent the misclassification of employees as independent contractors. In essence, the Guidance states that most workers are employees – not independent contractors – under the FLSA and implies that most, if not all, individuals treated as independent contractors by employers are inappropriately classified as such, and do not receive important workplace protections (including overtime). This is significant. Potential independent contractor misclassification could not just result in FLSA and DOL penalties, but also in the imposition of possible tax penalties and other penalties under the Affordable Care Act.

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