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Insurance Industry Employment Law Alert

How Insurance Industry Employers Can Navigate the New White-Collar Overtime Rules: Turning Legal Challenge Into Business Opportunity

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As most insurance industry employers are probably aware by now, the Department of Labor has proposed revisions to its regulations that seek to further limit the instances in which certain employees may qualify as exempt from the Fair Labor Standards Act's overtime pay and minimum wage requirements. The revisions it has proposed to the so-called "white-collar" exemptions (i.e., executive, administrative, and professional exemptions) will impact the American workplace as much as any legal development in the past decade. Employers will need to reexamine, and in many cases change, who they classify as exempt. For most insurance industry employers, the job positions of potential concern will likely include, at a minimum, entry-level insurance adjusters, special investigation unit employees, underwriters, and information technology employees. But to view the proposed changes merely as the time to endure a major legal audit over these positions, and possibly others as well, might be to overlook a broader opportunity. Drawing upon our deep experience counseling and partnering with insurance industry employers, we discuss in this Alert the portions of the proposed rules that are of most relevance to the insurance industry and how legal analysis of the proposed rules might be paired with broader business strategies in an evolving market.

What In the Proposal Should The Insurance Industry Pay Special Attention To?

As we have detailed in *previous Alerts*, the DOL's proposed rules would more than double, from $23,660 ($455 per week) to $50,440 ($970 per week), the minimum salary level required to meet any of the three white-collar exemptions. Moreover, the requirement would be indexed in perpetuity to the 40th percentile of weekly earnings for full-time salaried workers nationally, thereby automatically increasing the minimum salary level annually. Even employees in California, New York, or Alaska, who qualify for exempt status under those state laws, may not currently receive a high enough base salary to meet the DOL's proposed new minimum for exempt status, which would cause such employees to be deemed misclassified under federal law.

At this time, raising the minimum salary level is the focus of the DOL's proposed rule changes. The DOL has left open, however, the possibility that it might overhaul a second part of the white-collar exemptions—the "duties tests." At present, the FLSA's duties tests focus on an employee's key value or most important duty performed. Instead of this "primary duty test," the DOL is questioning whether it should adopt a California-style, bright-line test that requires employers to pay overtime to employees who devote more than 50% of their time to non-exempt work. Though the DOL did not publish a proposed rule to this effect, it has invited public comment on a series of questions on this issue. Those questions, which can be found by clicking [here](), may foreshadow an extraordinary shift to a California-style, quantifiable duties test when the DOL releases its final rules.

Finally, the DOL has stated that it is considering whether to add to the regulations additional examples of occupations that likely would and would not qualify for exemption, similar to those currently found in 29 C.F.R. §§ 541.203, 541.301(e), and 541.402. As insurance industry employers are likely aware, § 541.203(a) describes the types of duties performed by insurance claims adjusters that would likely qualify them for the administrative exemption. Section 541.402 describes the type of computer employees who likely qualify for the executive and administrative exemptions. If the DOL changes these examples in the final version of the regulations it ultimately publishes—particularly the example explaining that adjusters generally perform tasks that qualify for the administrative exemption—the impact on the insurance industry would be substantial.

What Can Insurance Industry Employers Be Doing To Prepare For The Changes?

First and foremost, we encourage insurance industry employers to participate in the comment process. Even without a change to the duties tests, we cannot overstate the impact that the salary level increase will have on the insurance industry, where many exempt employees' base salaries are below $50,000. If the duties tests are changed, the impact will be even more severe.

Seyfarth will be collecting employer comments through a series of roundtable discussions and other communications aimed at obtaining the views of the employer community. Employers may also participate in the comment process individually or through their trade associations.

The public has through September 4 to comment. The comment period might be extended by 30 days, but probably not longer. Following this comment period, the DOL will review the comments before issuing its final rules, most likely several months later. This gives members of your industry time to prepare themselves to act on the final rules quickly when they are issued. This is important as the window between issuance of the final rule and effective date of the final rule is likely to be no longer than a few months. Below we discuss not just the necessary initial step of assessing exempt-classified employees to determine their status under the new rules, but also a framework for acting on the results to leverage broader business objectives in an environment where insurance industry employers are already subjected to unprecedented levels of competitive pressure, public scrutiny, and regulatory oversight.

Step 1: Reevaluate Exempt Positions in the Existing Operating Model.

1. Assess salary levels against the salary test and consider changes.

To assess whether exempt-classified positions might need to be reclassified, insurance industry employers must assess both salary levels and job duties of their exempt employees. Because it involves a far simpler analysis, the former is the ideal first step. If current salary levels do not meet the proposed new minimum, and if raising them to do so is not an option, then employers need not waste time assessing duties under the potential new duties tests.

Assessing salary levels should be relatively straightforward. Most HRIS applications permit employers to run reports showing base salary levels across select exempt position codes. A base salary report will allow you to determine which employees and job positions fall below the new salary requirements.

In running such a report, be sure to include employees in all states. While some states, like California, New York, and Alaska, have minimum salary levels that are currently higher than the FLSA, the new salary level proposed by the DOL will surpass the salary levels even in those states. For example, a California employee earning a salary equivalent of at least $37,440 currently satisfies the salary level requirements of both the state and federal overtime exemptions. If the DOL's proposed rule changes become final, though, any employee earning a salary equivalent of less than $50,440 may soon not satisfy federal law.

Insurance industry employers that decide to reclassify certain employees rather than raise their salary levels must consider how to pay them and how to communicate the pay changes. You should navigate this path in conjunction with your legal department or your Seyfarth lawyer. The most common route will be to convert salaries into an hourly rate equivalent, with consideration given to a downward adjustment in the salary to account for possible overtime pay.

There may be some other options, however. For instance, if you have adjusters whose hours worked change from one week to the next due to fluctuations in the number of claims filed by insureds, a fluctuating workweek plan may be worth considering in jurisdictions where that payment method is permitted. And, of course, some employees, such as part-time employees and lower-level home office employees, who are paid less than the new salary threshold requirement may never or rarely work more than 40 hours per workweek. For those employees, no change actually needs to be made, as long as their employer takes steps to ensure that they do not work overtime hours and are being paid at least the higher of the federal or applicable state minimum wage rate for each hour worked.

For those employees who often work more than 40 hours per workweek and who you determine you need to reclassify, be mindful of the fact that these reclassified employees must accurately record their hours, including any overtime hours, worked and will not be accustomed to tracking their hours. If these reclassified employees fail to accurately record their actual hours worked, there is substantial risk that the company will face an agency investigation or lawsuit in which the reclassified employees claim that they have worked hours that they failed to record and, thus, for which they have not been paid. To reduce the risk of such "off-the-clock" claims and to have a strong defense in the event of such claims, you will need to ensure that your policies and procedures for timekeeping are clear and that the managers and supervisors of the reclassified employees are trained (or re-trained) on properly enforcing the timekeeping policies and procedures. If you choose to manage the reclassified employees' hours to try to avoid the incursion of unnecessary overtime hours, you will also need to give clear instruction to both the reclassified employees and their managers or supervisors on the process by which the reclassified employees should obtain pre-authorization before working overtime hours.

While there are a variety of new pay plan options and operational changes to consider for employees that an insurance industry employer may decide to reclassify, the need for a thoughtful change-management and communication plan will not. To reduce the likelihood of rumors or fears filling any gaps in understanding, insurance industry employers should work with counsel to carefully plan how they communicate the changes to those affected. While many insurance industry employers with California-based claims adjusters may have previously developed and implemented such plans in response to a California state court decision about 14 years ago finding adjusters in that state to be misclassified as exempt from overtime under state law, it is worth reminding employers that a change-management and communication plan should include at least the following: written materials explaining the reclassification; possible revisions or additions to the company timekeeping policies and practices to account for the need for the reclassified employees (some of whom may be field employees) to accurately record the hours they work; new training for the reclassified employees and their supervisors on proper timekeeping methods; and a precise timeline for the staging of the changes, communications, and new training.

Finally, if insurance industry employers are inclined not to reclassify certain at-risk employees but instead maintain their exempt status by raising their salaries, the broader implications of that decision should be carefully considered as well. It appears to be a practice of many insurance industry employers to create multiple levels of adjusters, underwriters, investigators, etc. and to pay more to those in the more senior levels in recognition of their ability to work more efficiently and handle more complicated work. If you have such a practice, you may also need to consider whether raising the salary levels of entry-level exempt employees necessitates raising the salary of the more senior-level employees in the same jobs. In other words, "bridging the gap" with respect to exempt employees whose salaries will fall short under the proposed new rules may present unique management and HR challenges beyond the group of employees who are directly impacted by the DOL raising the minimum salary level for exemption.

2. Analyze current duties under the FLSA Duties Test and consider changes.

Assuming that the salary level changes do not foreclose your interest in continuing to classify certain employees as exempt, you should consider partnering with your legal and human resources departments to assess which employees are most likely to be impacted by a California-like duties test. Acting now will put you in a better position to respond when the final regulations are announced. In doing so, carefully examine the at-risk employees' duties, both in design and in practice.

Job descriptions, training materials, performance evaluation materials, and the like are not dispositive of exempt status, but do reflect what the employer expects employees to do, how it trains them to do those things, and how it monitors performance against expectations. Just as important, however, is the practical consideration of what duties employees are actually performing. Are they actually performing the duties expected of them? How much time are they spending on those duties?

What additional duties are they performing, how much time are they spending on such additional duties, and do those duties impact the analysis under the duties test?

The process of evaluating duties will not be a one-size-fits-all endeavor. For some, we might recommend a careful approach limited to interviews with a sampling of the employees' supervisors, and even their supervisors' supervisors. For others, the better course might be a campaign to speak to as many employees as possible. Or the solution may be something of a hybrid. Factors that will impact the decision include, for example, the number of employees in the position, the depth of the employer's current understanding of the position, and, of course, the employer's resources and risk tolerance.

For positions you determine can pass muster under the new salary test and a potential time-based duties test, care should be taken to document the review, the results, and the rationale. Should there be litigation regarding the decision—and we expect there will be, just as when the regulations were last modified in 2004—this will provide you with evidence of your efforts to comply with the law, beyond the mere, "I remember we did something like …." Even if a judge were to later determine that the conclusion was wrong, the exemption assessment could establish the basis for a "good faith" defense, which, for an employer facing a large class action, could save millions of dollars.

Many positions that are currently classified as exempt might not survive a reconfigured, time-based duties test. Moreover, as mentioned above, the DOL could change the examples in its regulations of claims adjusters and computer employees who qualify for exemption. The current insurance claims adjuster example reads:

> 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.

It remains to be seen whether the DOL will retain, modify or eliminate this language in the new regulations. If either of the latter two scenarios occur, then insurance industry employers will have to rethink their exempt claims adjuster positions effectively from scratch, without the security of this regulatory safe harbor and the many subsequent court decisions finding adjusters to be exempt largely due to the above language in the current version of § 541.203(a).

The same may occur with respect to IT personnel as the DOL has explicitly mentioned its belief that employers could benefit from some additional examples of which computer employees would likely qualify for the administrative and executive exemptions.

Similar to the salary test, employers will have to determine how to address the gaps, if any, between what the employees are currently doing and what they need to be doing to be doing to be exempt. For example, employers might consider whether the delta can be bridged by adding duties to the position at issue or by relegating the more mundane, likely non-exempt tasks, to a non-exempt, subordinate employee. The answer to this question will invariably depend on the employer and the position at issue.

Step 2: In Deciding To Reclassify, Take Time to Identify Possible Operational Changes And Your Future Needs.

Beyond answering and acting on the most obvious question—do we need to reclassify—employers should take the opportunity to pause and consider current and future business objectives. Any changes to exempt-classified positions will impact operations, and the solution of simply converting exempt employees to hourly, non-exempt status may be tempting as the easiest solution. But there are additional operational considerations for managing the newly non-exempt employees going forward, and the range of possible solutions other than converting employees to hourly, non-exempt status is limited only by the bounds of creative thinking (and, of course, the law). It spans from changing duties to bolster the exemption, to converting the employees to salaried (rather than hourly) non-exempt status, to changing the management structure and labor model altogether.

Approaching this task creatively, we suggest that there may be ways to build a holistic plan that both accounts for the new FLSA requirements and maximizes the insurance industry's customers' experience as part of the overall long-term business strategy. Employers with long-term strategic plans should revisit those plans through the lens of these new regulations. Below are some examples of the kinds of operational changes to consider to meet the new requirements:

- If exempt employees are spending large amounts of time on non-exempt duties because doing so is necessary to meet customer or employer expectations or deadlines, employers could consider increasing staffing levels of non-exempt employees to fill the need so that exempt employees have the time to focus on exempt duties.

- If there are individuals in exempt positions who are spending large amounts of time on non-exempt duties because they are simply poor performers, employers should consider more frequent and explicit performance management to refocus such employees on their exempt tasks. If a poor performer cannot improve, employers should consider demotion of the employee to a non-exempt position. While this seems harsh in the abstract, poor performers are the ones who most often challenge their exempt status and, in doing so, try to focus the court on the duties they actually performed, thus risking the exempt status of the position as a whole. Due to both this risk and the obvious fact that they are not the ideal employees to be considering for succession planning, the safer course is to enhance your processes for improving their performance and removing them from their exempt position if they cannot.

- If formerly exempt employees will be reclassified as non-exempt, employers should consider whether to pay the re-classified employees on an hourly or salary basis, whether to reduce the base rate of pay such that the employees receive the same total compensation due to overtime pay (recognizing the morale issue such a change could cause), whether to implement measures to control the amount of overtime work performed by the reclassified employees to control labor costs, and whether to offer attractive pay or benefit proposals such as bonus incentives, vacation or leave availability, and other fringe benefits, to remain in a position to competitively attract and maintain employees who may view a non-exempt position as less prestigious or important to the company.

Conclusion

The impact of the new FLSA regulations on the insurance industry will be significant. Employers should act now. As many continue to evolve their business models to meet an ever-evolving competitive landscape, these changes present an opportunity to incorporate legal solutions into business strategies. In building legal mitigation into the core strategy, insurance industry employers can reduce the business disruption of these regulatory changes.

Please contact your Seyfarth attorney or any member of the Firm's 541 Amendments Task Force, listed below, to discuss these legal changes and what your company can do now to prepare to comply with the new regulations.

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