

# Staffing Company Class Codes: A shot in the dark?



Determining the correct class code for a particular job, jobsite location, and host employer is critical for a staffing company's success. The right class code ensures accurate premium calculations, proper experience modification promulgation, profitability and ultimately, the successful potential sale of your company.

By following best practices and staying updated on industry regulations, staffing companies can confidently navigate the complexities of class code assignments and protect their bottom line.

## Real-World Examples of Misclassification Issues

### EXAMPLE 1

The owner of a staffing company in California was desperate for help. He explained that his company had recently received a workers' compensation audit bill from the state workers' compensation fund for over \$80,000 and a policy cancellation notice that would become effective if they did not pay the audit within ten days.

The staffing company had used an incorrect class code for their largest client, a company that distributed small electronics. The staffing company provided employees who worked in their client's warehouse and performed picking, packing, shipping, receiving, and forklift duties. The staffing company used class code 3681 – TELEVISION, RADIO, TELEPHONE, OR TELECOMMUNICATION DEVICE MFG. NOC for their employees working for this client. At the time, the rate for this code in California was just over \$2.00. Additionally, the employer used the rate to develop the pricing for their host employer.

During the audit, the findings revealed that the correct class code for the staffing company client was 8292 – Warehouses—General Merchandise—NOC with a rate of over \$11.50, a difference of \$9.00. As a result, the insurance company reclassified all the payroll for this client's location and demanded payment in full. Subsequently, the staffing company went out of business. It couldn't pay the \$80K. Furthermore, the company could not move its workers' compensation policy to another company without disclosing unpaid premiums owed to its past insurance company. It could not go back to the client and adjust its pricing, and it could not continue to base their pricing on a \$2.00 rate and pay a rate over \$11.50.

When I asked the staffing company owner why it used class code 3681, the person explained that it was the code the client told them. Unfortunately, that is not how it works – that is not how any of this works! When it comes to workers' comp insurance for temporary staffing, it is incumbent upon the staffing agency to choose the correct code.

### EXAMPLE 2

A staffing company in Texas worked primarily for the energy industry with mobile welders who worked on oil pumping stations. The company was loss-free, had a credit-mod, and was very profitable. The owner explained that she had purchased the company from the prior owner and made no changes to their operation or the preceding owner's class codes.

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When an employee reported an eye injury, the owner sent the employee to the clinic. The employees received treatment for their injuries, and the clinicians released them for full duty. Although it was a minor injury, the bill from the clinic was under \$200.00. The owner submitted the first report of injury to the insurance company. Upon receiving the FROI, the adjuster processed the claim as a 'report only.' However, upon review, the adjuster questioned why an office clerical (8810) employee performed welding duties. The prior owner had misclassified their largest client, making the company seem profitable.

The company performed a mid-term audit, reclassified the entire account and applied the correct classification. Again, this forced the staffing company out of business. Once more, that is not how it works – that is not how any of this works!

### EXAMPLE 3

A staffing company, specializing in transportation and warehousing, was submitted to Nixer Comp. The underwriting process includes a thorough review of the currently active host employers, jobsites, and jobs to ensure that correct class codes are assigned. Upon underwriting review, a host employer that had been classified by the prior agent and workers' compensation company as 7219 - TRUCKING NOC—ALL EMPLOYEES & DRIVERS, which applies to trucking operations hauling general merchandise for others, was found to be hauling their own merchandise. This class code was reassigned to 7380 - DRIVERS, CHAUFFEURS, MESSENGERS, AND THEIR HELPERS NOC—COMMERCIAL, and their warehouse employees were reclassified to 8018 Store—Wholesale—NOC. These reclassifications resulted in a \$98,000 reduction in insurance premium.

### EXAMPLE 4

A medical staffing company, represented as being 100% hospital professional, class code 8833- HOSPITAL—PROFESSIONAL EMPLOYEES(NCCI), was submitted to Nixer Comp within just a few days of their renewal. Their payrolls were north of \$50,000,000. Submitted were 5-years of final premium audits from the prior workers' compensation company, as well as experience mod worksheets, and loss runs. Having this information in hand and in consideration of the short fuse on the renewal date, Nixer Comp's underwriting team decided to offer a bindable quote, and then complete the normal underwriting process, post bind. After binding the account, Nixer Comp requested the host employer, jobsite, and job information for the company's current host employers, based on the payrolls submitted. It was discovered that this medical staffing company was not 100% hospital professional, class code 8833. In fact, they only had one hospital. The rest of their host employers were all assisted living facilities, class code 8824-NURSING HOMES or ASSISTED LIVING FACILITIES – Healthcare Employees. The subsequent reclassification resulted in an additional premium of \$620,000. In this case, the insurance company had to cancel and rewrite the policy due to the difference in premium as originally quoted and bound.

If the average markup on the \$50M in payroll was 35%, the company's revenue would be nearly \$17.5M. If they had a profit margin of 10%, the net profit would be \$1,750,000. This would mean that the \$620,000 increase in premium would wipe out 35% of the net profits.

Just a few rhetorical questions for the reader:

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1. How would this scenario affect the company's EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization)?
2. What would happen if this error were discovered during the M&A process?
3. What would happen if this error were discovered after the M&A process?

As of this date, this staffing company has been client-insured of Nixer Comp's for 4 years.

## The Right Approach to Workers' Comp for Staffing Agencies: How Does it Work?

Every business entity is assigned a class code that reflects its greatest reported payroll under a certain class code. This class code is known as the company's dominant or governing class code. The rationale behind this approach is that this payroll represents the primary type of operation for the company. For instance, a plumbing company's greatest payroll should be under the plumbing class code. An electronics manufacturing company's greatest payroll should be classified under an electronics manufacturing class code.

However, the dominant or governing class code listed on the rating bureau website may not always coincide with the correct classification for the company. For instance, the company may be with a PEO, and it may be the PEO's dominant or governing class code that is displayed for the company on the rating bureau website. Therefore, it is important that you know what you are looking at.

Correctly, a class code is determined by understanding the operations of the company, the operations at the jobsite, and the job that is being performed. There are nuances that come into play as well. Some classifications are specific to temporary staffing companies and others do not apply to temporary staffing operations. Some industries don't have dominant or governing class codes. Others have class codes that include or exclude certain operations, where those operations must be rated separately. Furthermore, certain states have different class codes than other states.

One of the biggest mistakes a staffing company can make is asking the host employer what their dominant or governing class code is and then blindly assigning that code to temporary employees placed with that host employer. Staffing companies should always double check with their retail insurance agent and insurance company to verify the correct classification for a certain job being performed for a host employer. Unfortunately, there may not be a class code that explicitly describes every type of business. In this situation, a classification would be assigned that closely reflects or contemplates that business's operations. It is vital to always document this communication in an instance that needs to be referenced during the final premium audit. Even with this documentation, the final premium auditor can still change the code, but it may help in a formal dispute.

A staffing company may consider misclassifications a windfall when the rate is lower than that of the correct classification. However, this can have dramatic consequences to the accurate experience modification promulgation. The rate charged for that code reflects the exposures to loss that are common to their operations. The rate for each class code is calculated in consideration of the total losses reported under that class code in the applicable state per \$100 of payroll. This ratio is called the Expected Loss Ratio (ELR). Class codes with a low rate have a low expected loss ratio, and those with a high rate have a higher expected loss ratio. When a class code is incorrectly assigned to a certain job, it

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can't absorb the actual losses that are expected to occur per \$100 of payroll and as a result, the experience mod skyrockets. While the staffing company might be more competitive with the lower rate, the resulting experience mod is applied to all the payroll for the company, turning the windfall of the misclassification into a serious profit leak that will eventually sink the ship.

## What Is the Importance of Correct Workers' Comp Codes for Staffing Agencies?

- **Accurate Premium Calculation:**
  - Using the correct Workers' Compensation (Workers' Comp) codes ensures staffing agencies do not overpay premiums. Misclassifying a low-risk job as high-risk can result in unnecessarily high insurance premiums. Underestimating the risk by using incorrect codes can lead to penalties and retroactive premium adjustments. This can be disruptive for staffing agencies when corrections are made during audits.
- **Legal Compliance**
  - Accurate coding is essential for compliance with state and federal regulations. Incorrect Workers' Comp codes can lead to legal issues, including fines and sanctions from regulatory bodies. Proper classification helps defend against lawsuits by ensuring that all workers are appropriately covered under the Workers' Comp policy. This mitigates the risk of legal action from employees who may claim inadequate coverage.
- **Enhanced Risk Management**
  - Correct codes allow for better assessment and management of workplace risks. This helps implement targeted safety measures and reduce the likelihood of workplace injuries. With accurate codes, the claims process is more straightforward and less prone to disputes. This results in faster claim resolution and reduces administrative burdens.
- **Cost Control**
  - By ensuring the accuracy of Workers' Comp codes, staffing agencies can better manage their insurance costs, keeping them aligned with the actual risk associated with different job classifications. Accurate premium calculations based on correct codes facilitate better budgeting and financial planning. This ensures staffing agencies allocate appropriate funds for Workers' Comp insurance without overextending their resources.
- **Reputation Management**
  - Correctly classified Workers' Comp codes demonstrate a staffing agency's commitment to transparency and responsibility. It builds trust with the host employer and employees, enhancing the agency's reputation. Host employers are more likely to engage with staffing agencies that accurately manage their Workers' Comp codes, as it reflects a well-organized and compliant operation. This can lead to increased business opportunities and client retention.
- **Selling the Company**
  - In the scenario illustrated in the 4<sup>th</sup> example above, the misclassification resulted in a \$620K adjustment of premium, wiping out a third of the company's profit margin. This

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is a monster adjustment that could negatively swing the valuation of the company north of \$12M on the light side. If the company were in the middle of the M&A process, this would have likely blown the deal up completely. This could cause the buyer to walk away because of the risk of losing contracts/host employers or because it drops their threshold EBITDA requirements. You could expect the buyer to try and re-trade the deal, but the seller walks away. If the error had been discovered after the M&A process had been completed and Reps and Warranties (R&W) coverage, was it place, it may be covered, although R&W coverage may not be available for a deal this large. The Escrow could be hit, meaning that the seller would not be paid what they had agreed to sell the company for. Finally, in the M&A process, the staffing company owner would have made the representation that the company's numbers were accurate. Consequently, the seller could potentially be charged with fraud running the risk of tagging the fundamental representations and the disgorgement of all monies paid for the company.

## How to Determine the Correct Classification for a Temporary Staffing Agency

At a minimum, the staffing company should obtain the following information about the host employer and engage their retail insurance agent and the workers' compensation underwriter to learn everything they can about workers comp class codes for staffing agencies.

The insurance company underwriter will assign a class based on the information provided. However, the company can change the class code to avoid misclassification whenever they obtain additional information. Auditors are notorious for reclassifying codes, which can cost your company additional premiums and skew the pricing for your host employer.

- Company Legal Name
- Federal Employee Identification Number (FEIN)
- Company Physical Address
- Description of Company Operations
- Jobsite Physical Address
- Description of Jobsite Operations, including Final Service or Product
- Description of Job Duties and Responsibilities

Your agent should research this information before forwarding it to the underwriter. It might include analyzing the information provided on the company, state workers' compensation and rating bureau websites, business entity websites such as Manta, Facebook, LinkedIn, and insurance industry-specific sites. When obtaining workers' comp for staffing agencies, the more information provided at the time of the inquiry, the less of a chance for an adjustment by the insurance company during or at the end of the policy period.

## What Other Information is Helpful for Staffing Agencies?

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Staffing agencies should also review the following when choosing workers' comp insurance for temporary staffing host employer to ensure the workers are properly classified.

- Rating Bureau ID (NCCI or State Rating Bureau)
- Company Website
- NAICS Classification (North American Industry Classification System)
- SIC Classification (Standard Industrial Classification)
- Job/Position Descriptions (Not to be confused with Work Orders or POs)
- Brochures or other company literature
- Parent Company Legal Name
- Parent Company Federal Employee Identification Number (FEIN)
- Parent Company Physical Address

## Don't Confuse Obtaining a Class Code with Insurance Company Approval

Just because you know the correct class code does not mean your insurance company will approve using that code. There are a few reasons why your insurance company would not approve a code; it could be because there is a reinsurance exclusion for that code; it may be due to a review of the client's loss or OSHA history, or simply because the insurance company excludes that class of business altogether. Your company has the right to exclude any classification from your policy. It is essential to choose a company with a thorough understanding of workers' comp insurance for temporary staffing providers.

Each company has its own procedures for endorsing class codes to a policy. Some companies require that all new host employers get approved prior to placing any temporary employee at a specified location. Others let the staffing company use any code that is not explicitly excluded. Some request 941s quarterly throughout the policy period and adjust premiums based on the principles approved. It is important to remember that the workers' compensation auditor can make any necessary corrections/adjustments to the policy period based on the information at their disposal.

Therefore, it is imperative that all class codes get approved by the insurance company and endorsed to the policy before making the temporary placement. In addition to the information above, the insurance company should receive the following information.

- Job/Position Description
- Detailed Description of the Duties/Tasks the Employee(s) will be performing at or from the Jobsite location
- Detailed Description of any unusual tasks, airborne exposures, or any other potential hazards to which your employees (Temps) might get exposed at the job site location.
- Number of Employees provided
- Length or Job Assignment Term
- Average hourly payroll rate for this placement
- Gross Payroll for the Term

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Once a staffing company submits the information to the insurance company, approval should take less than 24 hours. Your insurance agent should oversee this process to ensure they agree with the assigned code based on the information provided.

### **Elevate Your Staffing Business with Nixer Comp's Workers' Compensation Solutions**

Navigating Workers' Compensation can be complex for temporary staffing agencies. Nixer Comp offers tailored insurance and claims management solutions designed specifically for your industry. Our expertise and commitment to efficient, compassionate care ensure your employees and business are protected and well-supported.

Choose Nixer Comp to help navigate Workers' Compensation insurance for temporary staffing agencies—because your employees deserve prompt, effective care, and your business deserves strong protection and support.

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#### **About the Author**



Rob Schild is the founder and President of Nixer Comp, a national A-VIII rated workers' compensation program, designed specifically for the temporary staffing industry.

Rob has more than 20 years of insurance industry experience, beginning his insurance career in Miami Florida, where he focused on hard-to-place workers' compensation and liability. In 2005, his agency was sold, forcing Rob to move his family to Orlando Florida, where he joined Insurance Office of America (IOA), one of the nation's largest, privately held, retail insurance agencies. There he continued building his staffing practice.

In 2019, he met his business partners who financed his plan to create a specialty workers' compensation program dedicated to helping staffing companies achieve best-in-class results. Nixer Comp received its license to commence writing policies on April 1st, 2020. A year later, Rob retired from IOA where he served as the National Staffing Industry Practice Director, Vice President, and partner.

Today, Rob leads an experienced team of insurance industry, workers' compensation and claims professionals focused solely on delivering the services that produce best-in-class results, profits, and EBITDA margins for our temporary staffing policy holders.